Ontario

Ontario
Energy
Board

In the matter of a
Reference respecting
Unicorp Canada Corporation/
Union Enterprises Ltd.

E.B.R.L.G. 28

REPORT OF THE BOARD

Volume I

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E.B.R.L.G. 28

IN THE MATTER OF a reference pursuant to section 36 of the Ontario Energy Board Act, R.S.O. 1980, c.332 from the Lieutenant Governor in Council by Order in council dated the 15th day of February, 1985 to the Ontario Energy Board.

AND IN THE MATTER OF a public hearing to examine and report upon certain matters respecting the implications for energy supply, gas rates and service of a proposed acquisition of certain shares of Union Enterprises Ltd. by Unicorp Canada Corporation; and the question of the need for or desirability of the public review and regulation of both the direct and indirect ownership and control, and transfers thereof, of gas distributors, transmitters and storage companies in Ontario.

BEFORE: R. W. Macaulay, Q.C.
Chairman

D. A. Dean
Member

O. J. Cook
Member

August 2, 1985

Ontario

Ontario
Energy
Board

14 Carlton Street
Toronto, Ontario
M5B 1J2
416/598-4000

August 2, 1985

To His Honour the Lieutenant Governor in Council

The Ontario Energy Board was required by Order in Council 339/85 to examine, and after holding a public hearing to report on the impact on the business, customers and service of Union Gas, and on energy supply in Ontario, of the acquisition by Unicorp Canada Corporation of more than 20 percent of the shares of Union Enterprises Ltd., which holds all of the common shares of Union Gas. The Board was also asked to report on the need for or desirability of public review and regulation of the direct and indirect ownership and control of gas distributors and transmitters in Ontario. The Board submits its report herewith.

Respectfully submitted,

ONTARIO ENERGY BOARD

R. W. Macaulay, Q. C.
Chairman

D. A. Dean
Member

O. J. Cook
Member

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INTRODUCTION

On February 1, 1985, Unicorp Canada Corporation commenced an attempt to take over Union Enterprises Ltd., a holding company whose major asset was Union Gas, one of Ontario's three major natural gas utilities regulated by the Ontario Energy Board. The takeover was resisted by the management of Union Enterprises and a highly public struggle for control ensued.

The Lieutenant Governor in Council, on the recommendation of the Minister of Energy, issued an Order in Council on February 15, 1985, requiring the Ontario Energy Board to hold a hearing and report to the Lieutenant Governor in Council on the impact of the purchase of Union Enterprises by Unicorp on the operations of Union Gas and on the more general question of review and regulation of ownership and control of natural gas utilities in Ontario.

After the Order in Council was issued, but before the Energy Board's hearing was underway, Unicorp was successful in acquiring control of Union Enterprises and a settlement agreement between the two parties was drawn up. Subsequently a set of joint undertakings from Unicorp and Union Enterprises was presented to the Board which make certain commitments regarding Union Gas.

The current Ontario Energy Board Act, Section 26(2), requires the approval of the Lieutenant Governor for any acquisition of 20 percent or more of the common shares of a natural gas utility. However, the section does not provide for the possibility of the takeover or change of control of a holding company which owns or controls a natural gas utility.

All three Ontario natural gas utilities, Consumers' Gas, Union Gas and Northern and Central gas have previously undergone changes in corporate structure which have resulted in each of them being controlled by holding companies, and which have been approved by the Lieutenant Governor. In the case of Unicorp's takeover of Union Enterprises, there was an indirect change of control of a major natural gas utility which therefore challenged existing legislation.

At the hearing held by the Board between April 9 and May 1º, 1985, arguments and evidence was presented by parties to the takeover transaction, by intervenors on behalf of industry, municipalities, political parties and by individuals, and by the Ontario Energy Board Counsel. Details of significant financial transactions which enabled Unicorp to be successful in its takeover bid were made public for the first time.

During the hearing, the Board had the benefit of an exceptional range of informed and expert witnesses. Significant evidence was presented that caused the Board to examine not only its role during the transfer of ownership or control of a natural gas utility, but also its regulatory powers in general, and its ongoing responsibilities and authority.

The Board is conscious of the importance of the government retaining its power of approval over the control or ownership of the three major natural gas utilities. Examination of the case and evidence at the hearing has convinced the Board of the need to identify more strongly its areas of regulatory power, in order to to reflect the evolution of corporate structure and ownership of the natural gas utilities that has occurred in recent years. The Board also recognizes the value of the natural gas utilities being economically unfettered. Utilities should not be pawns in the transactions of holding companies, but they should have the freedom to benefit from vigorous management and ownership.

Chapters 1 to 5 of this Report describe the role of the Board, give details of the hearings, outline the process of the takeover and the parties to it and summarize the arguments of the participants at the hearing.

Chapter 6 delineates the principle of the public interest which the Board has applied in this case.

Chapter 7 relates the issues of holding companies, takeovers and concentration of control as they apply to natural gas utilities, and recommends that, subject to other recommendations, no action be taken to interfere with the Unicorp takeover of Union Enterprises.

Chapter 8 contains findings on some specific issues relating to this case.

Chapter 9 analyses the joint undertakings offered by Unicorp and Union Enterprises in relation to the OEB's key areas of regulatory concern. Important aspects of the Board's powers are reviewed and the status of all existing undertakings relating to natural gas utilities is examined.

Chapter 10 gives a history of the Ontario legislation relating to the ownership and control of natural gas utilities, and a survey of comparable legislation in other provinces.

Chapter 11 considers the best manner in which the Government can continue to excercise its concern for the change in control of a gas utility.

Chapter 12 summarizes the Board's recommendations.

Volume II of the Report contains appendices which summarize the evidence of witnesses, provide maps of the operating areas of the natural gas utilities, charts of the relevant corporate structures and copies of the undertakings and orders in council.

1. THE ROLE OF THE ONTARIO ENERGY BOARD

1.1 The distribution of natural gas within Ontario to residents, businesses and industry is fundamental to the economy of the province. It is an essential service, and consequently one with which the legislature has long had a deep concern.

1.2 There are three major gas distributors in Ontario which together serve approximately 1,462,000 customers. Each gas distributor is granted franchises to operate a monopoly within a given area: Union Gas operates within south-western Ontario, Consumers' Gas operates in southern, central and eastern Ontario, and Northern and Central Gas operates in north-western, northern and easter Ontario. The combined assets of the three total $3.3 billion.

The total revenue of these utilities was approximately $3.7 billion in 1984.

1.3 Since these gas utility franchises are monopolies created in the public interest, their ownership is a matter of public concern and has traditionally been subject to approval by the Government of Ontario, through legislation established in the Ontario Energy Board Act.

1.4 The existing legislation, section 26(2) of the Ontario energy Board Act requires that notice be given and approval be obtained for any person to acquire 20 percent or more of the common shares of a natural gas utility.

1.5 In February, 1985, Unicorp Canada Corporation, a holding company mainly active in the field of real estate, began proceedings to acquire shares to gain control of Union Enterprises, a holding company whose major holding was Union Gas. The takeover was vigorously contested by Union Enterprises and highly publicised.

1.6 Since the proposed takeover of control of the natural gas utility was indirect, the existing legislation was not directly applicable. However, the Lieutenant Governor in Council, noting that Union Gas was subject to regulation under the Ontario Energy Board Act, and that the proposed takeover was the subject of public concern, on February 15, 1985 issued an Order in Council ordering the Ontario Energy Board to hold a public hearing and report to him pursuant to Section 36 of the OEB Act, which reads as follows:

> The Lieutenant Governor in Council may require the Board to examine and report on any question respecting energy that, in the opinion of the Lieutenant Governor in Council, requires a public hearing."

1.7 The Order in Council states:

> WHEREAS Union Gas Limited ("UGL"), Canada's second largest distributor of natural gas, plays a vital role as an energy supplier to the Ontario economy, owning and operating a fully integrated natural gas transmission, storage and distribution system located in southwestern Ontario serving approximately 492,000 industrial, commercial and residential customers and providing transmission services to TransCanada PipeLines Limited and transmission and storage services to other major distribution companies; and
>
> WHEREAS UGL is a distributor and transmitter of gas within the meaning of the Ontario Energy Board Act and is therefore subject to regulation under that Act; and

WHEREAS Unicorp Canada Corporation ("Unicorp"), a publicly traded corporation, has made a public offer to purchase by way of share exchange any and all of the outstanding common shares of Union Enterprises Ltd.("Enterprises"), a publicly traded corporation which holds all of the common shares of, and therefore con- trols, UGL; and

WHEREAS a number of major customers of UGL, and a number of municipalities from which UGL holds service franchises, have expressed considerable concern and are seeking assurances that their interests and the public interest in price, service and reliability will not be jeopardized by the proposed transaction; and

WHEREAS Council is of the opinion that the proposed transaction raises questions respecting energy which require a public hearing:

THEREFORE pursuant to section 36 of the Ontario Energy Board Act the Ontario Energy Board be required to examine and, after holding a public hearing with respect thereto, report to the Lieutenant Governor in Council on:

1. The probable and potential impact:
   - i) on the storage, transmission and distribution business and activities of Union Gas,
   - ii) on the present and future customers of Union Gas, in terms of both service and rates,
   - iii) on those who contract with Union Gas for storage or transmission services, and
   - iv) on energy supply in Ontario

> of the acquisition by Unicorp, pursuant to an offer dated February 1, 1985 made by Unicorp to the holders of all of the common shares of [Union] Enterprises, and any modifications of the said offer, of more than 20 % of the common shares of Enterprises; and
>
> 2. the need for or desirability of the public review and regulation of both the direct and indirect ownership and control, and transfers thereof, of gas distributors and transmitters in Ontario.

1.8 It may be useful at the outset of this report to review briefly the duties of the OEB which are set out in the OEB Act.

1.9 The OEB regulates all natural gas utilities in Ontario except those municipally owned and controlled by the cities of Kingston and Kitchener. It is responsible for determining rates and charges for the transmission, storage, distribution and sale of natural gas in the province; for designating and authorizing of natural gas storage areas; for authorizing construction of transmission lines; for authorizing expropriations for natural gas pipelines; and for approving franchises for natural gas utiities to serve designated areas. The OEB acts upon references from the Minister of Energy regarding Ontario Hydro's wholesale rates and other rate-related matters; from the Minister of Natural Resources regarding certain oil and gas matters; and from the Lieutenant Governor on any question respecting energy.

1.10 Under the Muncipal Franchises Act the OEB approves the terms of a proposed by-law granting a franchise to supply gas to a municipal corporation or to distribute gas in the municipality, and extends the term of such franchise or of a transmission franchise.

1.11 The OEB grants certificates of public convenience and necessity to construct works and supply gas in municipalities.

1.12 Under the Petroleum Resources Act, and upon reference from the Minister of Natural Resources, the OEB reports on certain applications for permits and licences.

1.13 Under the Public Utilities Act, the OEB controls gas utilities that contravene municipal by-laws prohibiting the distribution and sale of gas containing sulphuretted hydrogen.

1.14 Under the Assessment Act, the OEB decides whether certain gas pipelines are transmission lines for assessment purposes.

1.15 Under the Toronto District Heating Corporation Act, 1980, the OEB, upon appeal by a customer, fixes steam rates for certain customers of the Toronto District Heating Corporation.

1.16 Most important to this case, the OEB reports to the Lieutenant Governor on applications by gas utilities to sell their assets or amalgamate with other utilities and on applications by persons to acquire shares of a gas utility which would result in a holding of more than 20 per cent of any class of shares.

2. THE HEARING

2.1 The Lieutenant Governor issued an Order in Council dated February 15, 1985 directing the Ontario Energy Board to examine and, after a public hearing, to report on the Unicorp takeover of Union Enterprises and on the need for public review and regulation of ownership and control and transfers thereof, of gas utilities. These two aspects are referred to in this Report as Phase I and Phase II respectively. On February 18, 1985 the Board issued its Notice convening the public hearing ordered by the Lieutenant Governor. The Notice invited interested persons to make submissions, outlined the intervention procedure and the matters to be considered in evidence. The Notice also defined the areas of the public interest to be addressed.

2.2 In order to assist intervenors and the general public, the Board issued a series of questions to be answered by Unicorp and Union Enterprises as part of several procedural orders. Other procedural orders contained summonses to witnesses or dealt with other administrative matters.

2.3 Unicorp and Union Enterprises provided written answers to questions put to them in the Board's procedural orders, and also provided additional pre-filed evidence in advance of the hearing both from company witnesses and from expert witnesses. All such pre-filed written evidence was entered as exhibits at the hearing.

2.4 The first day of the hearing was on March 13, 1985, and dealt with procedural matters. At that time the Board postponed the date for the resumption of the public hearing from March 19 until April 9, 1985. This was done at the request of Union Enterprises and without objection from any other participant. The public hearing resumed on April 9, 1985 and finished on May 29, 1985. There were twenty-nine hearing days.

Letters of Concern

2.5 A total of 288 letters were received by the

Board from eighty-one companies and school boards, seventy city councils and townships and 137 concerned individuals. A summary of the concerns was read into the record by Board Counsel and all were entered in the record collectively as Exhibit 6. The views expressed by the writers have been taken into account by the Board in making its findings.

Participants

2.6 The initial participants in the hearing and their Counsel were as follows:

- Unicorp Canada Corporation represented by Mr. C. C. Lax, Q.C., Mr. A. Leibel, Ms. Julia Ryan and Mr. J. D. Alton;
- Union Enterprises Ltd./Union Gas Limited represented by Mr. J. F. Howard, Q.C. and Mr. J. L. Ronson;
- Ontario Energy Board Counsel, Mr. J. Campion.

2.7 Other active intervenors were:

- Industrial Gas Users Association ("IGUA"), represented by Mr. P. C. Thompson, Q.C.;
- Inter-City Gas Corporation , represented by Mr. J. Roland, Q.C. and Mr. D. Brett;
- Hiram Walker Resources Limited, represented by Mr. C. Campbell, Q.C.;

- The Consumers' Gas Company Ltd. represented by Mr. R.S. Paddon, Q.C.;
- The Regional Municipality of Haldimand-Norfolk and The Corporation of the City of Chatham, represented by Mr. T. A. Cline, Q.C.;
- The Corporation of the City of Kitchener, represented by Mr. C. M. McGilp, Mr. J. A. Ryder, Q.C., and Mr. J. Wallace;
- Energy Probe, represented by Mr. D. Poch;
- Certain industrial gas users, represented by Mr. S. Kawalec;
- The Ontario New Democratic Party Caucus

2.8 In addition, the following individuals participated in the hearing but were not represented by counsel:

- Mr. Bram Verhoeff, on behalf of himself;
- Mr. Achiel Kimpe, on behalf of himself;
- Mr. T.R. Close, on behalf of the Chatham and District Chamber of Commerce;
- Messrs D. and N. McGeachy, on behalf of the McGeachy Charitable Trust;
- Mr. Nichol, on behalf of himself and his wife;
- Mr. & Mrs. La Bombarde, on behalf of themselves;
- Mr. C. M. Tatham, on behalf of the County of Oxford.

2.9 The following organizations filed interventions but did not participate in the hearing:

- Natural Resource Gas Limited
- Petrosar Limited
- Du Pont Canada Inc.
- TransCanada PipeLines Limited
- Municipality of Hamilton-Wentworth
- Mr. L. Donofrio on behalf of the Liberal Party Caucus

Witnesses

2.10 The following witnesses appeared on behalf of Unicorp.

- Mr. James W. Leech
  President, Unicorp Canada Corporation
- Mr. G. R. Cowan
  Senior Investment Analyst, Levesque Beaubien Inc.
- Dr. C. J. Cicchetti
  Vice-President, National Economic Research Associates Inc.; Professor of Economics and Environmental Studies, University of Wisconsin, Madison; former Chairman, Public Service Commission of Wisconsin
- Mr. K. J. Slater
  Senior Vice President, Energy Management Associates Inc., Atlanta, Georgia

- Mr. J. J. Oliver
  Senior Vice President, Nesbitt Thomson Bongard Inc.
- Dr. W. R. Waters
  Professor of Economics and Finance, University of Toronto
- Mr. George S. Mann
  Chairman, Unicorp Canada Corporation
- Dr. W. J. Baumol
  Professor of Economics, Princeton and New York Universities

2.11 The following witnesses appeared on behalf of Union Enterprises and Union Gas.

- Mr. F. M. Edgell
  Senior Vice President, Utility Operations, Union Gas Limited
- Mr. M. J. O'Neill
  Treasurer, Union Gas Limited and Union Enterprises Ltd.
- Mr. T. E. Kierans
  President, McLeod Young Weir Limited
- Dr. G. R. Hall
  former Commissioner, U.S. Federal Energy Regulatory Commission; Vice President, Charles River Associates, Boston, Massachusetts
- Mr. W. Darcy McKeough
  Chairman, Union Gas Limited and Union Enterprises Ltd.

2.12 The following witness appeared on behalf of Consumers' Gas.

- Mr. R. Martin
  President and Chief Executive Officer,
  The Consumers' Gas Company Ltd.

2.13 The following witnesses appeared on behalf of Inter-City Gas Corporation.

- Mr. R. G. Graham
  President and Chief Executive Officer,
  Inter-City Gas Corporation
- Mr. H. E. Andrews
  Vice President of Finance and Regulatory Affairs, Northern and Central Gas Corporation Limited

2.14 The following witnesses appeared on behalf of the Ontario Energy Board Counsel.

- Dr. W. T. Cannon
  Associate Professor of Finance,
  Queen's University
- Dr. J. R. Baldwin
  Associate Professor of Economics,
  Queen's University

2.15 The following witnesses appeared at the request of Ontario Energy Board Counsel.

- Mr. J. A. MacNaughton
  Director, Burns Fry Limited

- Mr. J. R. Connacher
  Chairman and Chief Executive Officer,
  Gordon Capital Corporation
- Mr. T. Eyton
  President and Chief Executive Officer,
  Brascan Limited
- Mr. J. Cockwell
  Executive Vice President and Chief Operating Officer, Brascan Limited
- Mr. Paul Reichmann
  Senior Executive Vice-President,
  Olympia & York Developments Limited
  (evidence provided by affadavit)

2.16 An analysis of the positions of the participants is presented in Chapters 4 and 5 of this report. A summary of the evidence of witnesses is presented in Appendix A in Volume II.

Transcripts and Exhibits

2.17 A verbatim transcript was made of all the proceedings. The full transcript of 4,149 pages and all the exhibits filed with the Board in connection with this hearing are held at the Board's offices and are available for public examination.

3. THE TAKEOVER OF UNION ENTERPRISES

3.1 This chapter presents a description of Union Enterprises and of Unicorp, gives an overview of the transactions that took place during the takeover, and summarizes the settlement agreement between the two parties.

Union Enterprises

3.2 Union Enterprises is a publicly traded company which, since January 1, 1985, has operated as a holding company with two wholly-owned subsidiaries, Union Gas (one of the three major regulated natural gas distributors in Ontario) and Union Shield Resources. These companies' assets totalled $1,399,241,000 as at March 31, 1984 and $1,801,633 at March 31, 1985. The chairman and chief executive officer of Union

Enterprises at the time the takeover activity commenced was Mr. W. Darcy McKeough.

3.3 Union Enterprises had originally been incorporated in 1961 and was a wholly-owned subsidiary of Union Gas until January 1, 1985. At that time, Union Gas reorganized its corporate and financial structure in order to segregate its utility assets from its non-utility assets.

3.4 Under the reorganization, Union Gas retained all of its utility assets, which are subject to regulation by the Ontario Energy Board, and a new entity, Union Shield Resources acquired all of the company's unregulated non-utility assets. Union Enterprises became the parent of these two companies, holding 100 per cent of the common shares of each company.

3.5 Union Gas owns and operates a fully integrated natural gas transmission, storage and distribution system in southwestern Ontario, which serves approximately 505,000 industrial, commercial and residential customers and provides transmission and/or storage services to several major distribution companies. Union Gas operates under franchises granted by a number of municipalities, and its rates are subject to regulation by the Board. (A map showing the

Union Gas distribution, transmission and storage areas is shown in Appendix B-1.

3.6 At the time of the reorganization, the non-utility assets which were acquired by Union Shield Resources consisted primarily of shareholdings in two natural resource exploration companies based in western Canada, Precambrian Shield Resources Limited and Numac Oil & Gas Ltd. Union Shield holds 65.6 percent of the common shares and $20,000,000 worth of preference shares in Precambrian, and 18.3 percent of the common shares of Numac. These investments together amounted to 17 percent of Union Enterprises' total assets.

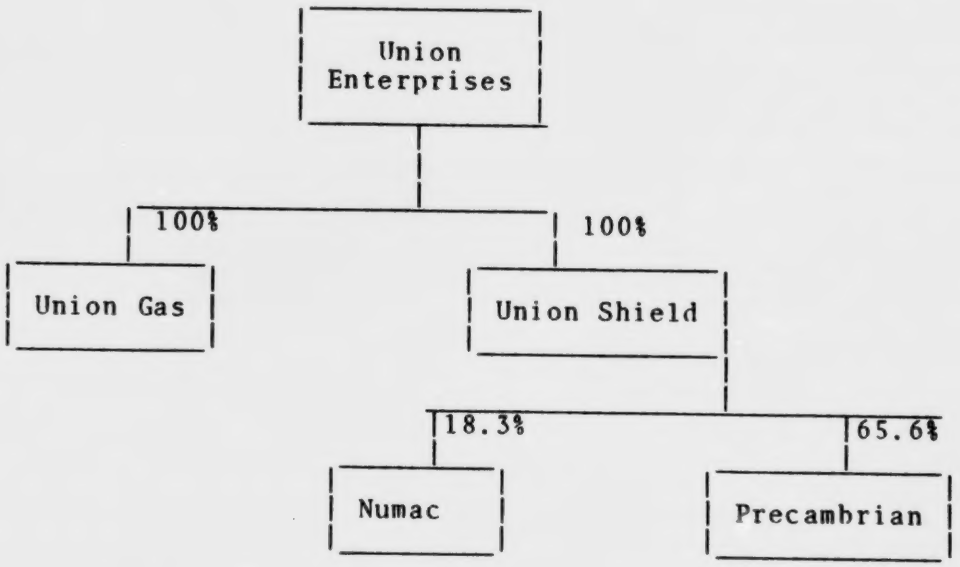
3.7 At the time of the restructuring, these assets were transferred to Union Shield which, in consideration therefore, issued preference shares having an aggregate redemption value equal to the fair market value of these assets ($200,000,000) to Union Gas. Union Gas then paid a $96,000,000 dividend to Union Enterprises, which invested it in Union Shield, which immediately used the funds to redeem $96,000,000 of the preferred shares which it had issued to Union Gas in exchange for the non-utility assets. Thus, at the completion of the reorganization, Union Gas held $104,000,000 worth of Union Shield's preferred shares.

3.8 After the Union Enterprises reorganization, the common shareholders of the previous Union Gas became common shareholders of Union Enterprises through a share-for-share exchange, whereas the preferred shareholders and holders of long-term debt retained their interests in the new Union Gas directly.

3.9 Union Gas stated in its reorganization petition that this restructuring was intended to facilitate regulation by the Ontario Energy Board and diversification. Since Union Gas's utility operations would continue unchanged, the company applied to the Lieutenant Governor under Section 35 for an exemption from compliance with Section 26(2) of the OEB Act. Section 26(2) prohibits a gas distributor from amalgamating with another company, and prohibits any person from accumulating over 20 per cent of a class of shares of a gas distributor, without first obtaining leave of the Lieutentant Governor, which acquisition would otherwise have required a public hearing by the OEB.

3.10 The application for exemption was accompanied by undertakings provided by Union Gas which were designed to protect the operations, investors, and customers of Union Gas. (These undertakings are discussed in Chapter 9 and presented in Appendix D-4.) Leave was granted and the reorganization was effected without a public hearing.

3.11 With the completion of these changes on January 1, 1985, the corporate structure was as follows.


Union Enterprises
100%
100%
Union Gas
Union Shield
18.3%
65.6%
Numac
Precambrian

3.12 Two observations should be made about this reorganization.

i) By making the natural gas utility, Union Gas, a subsidiary of a holding company, the management was following a pattern already established by the owners of Ontario's other two major natural gas utilities: Northern and Central is controlled by Inter City Gas Limited, and Consumers' Gas is controlled by Hiram Walker Resources Limited.

ii) The shares of the reorganized Union Enterprises, like those of the former Union Gas, were widely held. The largest single shareholder was GLN Investments Limited, a company controlled by Brascan Limited, which owned 16 per cent of the common shares. The new holding company, Union Enterprises, was thus vulnerable to a takeover, because the provisions limiting ownership of natural gas utilities under section 26 of the Ontario Energy Board Act were generally believed not to apply to holding companies controlling the regulated utility.

Unicorp Canada Corporation

3.13 Unicorp is a publicly traded, asset-oriented company with investments and operations in commercial real estate, energy, financial services and marketable securities. It was created by the amalgamation of Unicorp Financial Corporation and Sentinel Holdings Limited on December 31, 1979. Unicorp is controlled by George Mann who controls 68 percent of the outstanding Class B voting shares.

3.14 Since 1978 Unicorp has demonstrated a remarkable record of growth. The book value of its assets has grown from approximately $41 million to $480 million, an annual compound growth rate of over 50 per cent. The appraised value of its assets in the same period has grown from $43 million to $678 million, an annual compound rate of over 59 percent. Much of this growth is the result purchase of American Real Estate Investment Trusts at prices less than the value of their underlying assets, and the subsequent resale of selected properties. Thus, until recently, the company has focussed on asset growth rather than on revenue from operations.

3.15 Unicorp's assets totalled $479,851,000, as of December 31, 1984, of which approximately 74 percent were located in the United States. The following table provides a breakdown of assets by location and activity at that time, prior to its takeover of Union Enterprises.

3/8

BREAKDOWN OF UNICORP'S ASSETS
Net Book Values at December 31, 1984
(thousands of dollars)

Assets	Canada		United States		Total	Percentage of Total Assets
Real Estate	9,856	(3.0%)	315,510	(97.0%)	325,366	67.9%
Energy	70,115	(100.0%)	-	(-)	70,115	14.6%
Investments	36,272	(56.2%)	28,322	(43.8%)	64,594	13.4%
Other	9,088	(46.0%)	10,688	(54.0%)	19,776	4.1%
Total	125,331		354,520		479,851	100%
Percentage of Total Assets	26.1%		73.9%		100%	

Source: Exhibit 10.6, Page 5

The Takeover

3.16 Unicorp began purchasing Union Enterprises shares soon after Union Enterprises reorganized itself on January 1, 1985. Unicorp had originally held only 100 shares in Union Enterprises, which had been purchased as Union Gas shares prior to the reorganization. By the end of January 1985, Unicorp held 4,470,000 shares in Union Enterprises, or 13.8 percent of the outstanding voting common shares. These had been purchased on the open market at an average price of $13.00 per share.

3.17 On January 30, 1985, Unicorp made a firm offer to buy 5,290,000 common shares of Union Enterprises from GLN Investments. These constituted 16.3 percent of the outstanding shares. This offer was accepted.

3.18 Unicorp then made a public offer (dated February 1, 1985) to purchase any and all of the outstanding common shares of Union Enterprises on the basis of one Unicorp $1.17 Cumulative Redeemable Retractable Class II Preference Share, Series B and one-half of a Class A Non-Voting Share Purchase Warrant for each Union Enterprises common share. The offer was to expire at midnight on February 22, 1985, unless extended (which it was).

3.19 Each Unicorp Preference Share will pay quarterly dividends at an annual rate of $1.17 and will be redeemable at $13.00 per share at the option of Unicorp on or after March 31, 1988, and retractable at the option of the holder for $13.00 per share on March 31, 1992, and each March 31st thereafter. The Unicorp Warrant will entitle the holder to purchase one Class A Non-Voting Share of Unicorp on or prior to March 1, 1987 at a price of $9.75 per share.

3.20 Upon making the offer, Unicorp assured shareholders that it had no intention, at that time, of seeking any material change in the operations, management, assets or dividend policy of Union Enterprises. However, it stated that it did intend to seek representation on Union Enterprises' Board of Directors in proportion to its shareholdings. Nevertheless, on February 6, 1985, Union Enterprises' Board of Directors urged its shareholders not to deposit their shares in response to Unicorp's offer.

3.21 Both Unicorp and Union Enterprises argued their opposing views on the merits of the Unicorp offer in many full page newspaper advertisements in an effort to gain the support of uncommitted Union Enterprises shareholders. In addition to the advertisements and press releases issued by the two parties, there were many newspaper and magazine articles and television items about the dispute. Active press coverage continued throughout the hearing.

3.22 On February 15, 1985 the Ontario Securities Commission decided, after a six-day hearing into the question of the Unicorp bid's compliance with securities laws, that the takeover would be allowed to proceed. The OSC is a regulatory body which monitors trade in the Ontario securities market. The OSC establishes standards for behaviour in the market and backs them up with sanctions. Its functions are to police the industry and to provide it with professional standards. Like all regulatory boards, its broad function is the protection of the public interest. In its mandate, the public interest is defined as the interest of the investing public in its trade in the securities market. (It should be noted that the "public interest" with which the OEB is concerned is broader than that which guides the OSC. See Chapter 6.)

3.23 On February 15, 1985 the matter of the takeover was referred to the Ontario Energy Board by an Order in Council from the Lieutenant Governor, as described in Chapter 1.

3.24 Unicorp subsequently sought judgement from the Divisional Court of the Supreme Court of Ontario that the OEB's definition of the public interest in its Procedural Order relating to its hearing was too broad. The Board believed its responsibility for the public interest extended to the shareholders of utilities and therefore was requesting financial details relating to Unicorp and its offer. On March 14, 1985 the Court dismissed this application by Unicorp to limit the scope of the OEB's hearing. Subsequently, Unicorp filed testimony from Mr. George S. Mann, its chairman, and Mr. James D. Leech, its president, in response to the Board's questions in its procedural order. (At this time, on its own initiative, Unicorp also filed with the Board, certain undertakings. These paralleled earlier undertakings from Inter-City Gas, the holding company controlling Northern & Central Gas, and Hiram Walker Resources, the holding company controlling Consumers' Gas. which had been accepted by the Lieutenant Governor at the time of a change of control in these companies.)

3.25 Following the Order in Council referring the takeover to the OEB, Unicorp had amended its offering circular by adding information describing the terms of the Order in Council as well as other matters required by the OSC. At the same time Unicorp extended its offer to acquire Union Enterprise shares until March 11, 1985, and the date on which shareholders could withdraw shares tendered, was extended to March 1, 1985.

3.26 On March 1, Unicorp took up and paid for 7,295,000 shares tendered under the terms of its offer. Its holdings in Union Enterprises then totalled 11,795,000 shares or 36 percent of the outstanding common shares.

3.27 Meanwhile, on March 7, Union Enterprises acquired 100 per cent of Burns Foods Limited, a Calgary-based food processing and distribution company, for $125,000,000. In order to effect this transaction, Union Enterprises issued 10,000,000 senior Class A convertible 8 percent preferred shares with a stated value of $12.50 in exchange for all of the outstanding shares of Burns Foods. These shares are redeemable by Union Enterprises at a price of $12.50 after April, 1987 and retractable by shareholders as of the same date and semi-annually thereafter. In other words, within two years, Union Enterprises may be required to pay out the $125,000,000 to redeem these shares. The preferred shares will each carry four-fifths of a vote, which increases the total shareholder vote by 8,000,000, or 24.2 percent. The shares are also convertible into Union Enterprises common shares at a price of $13.50 up to April, 1990. However, the former shareholders of Burns Foods have given up conversion rights on some of the Union Enterprises shares in order to limit the dilution to a maximum of 25 percent. This was done to comply with a rule of the Toronto Stock Exchange.

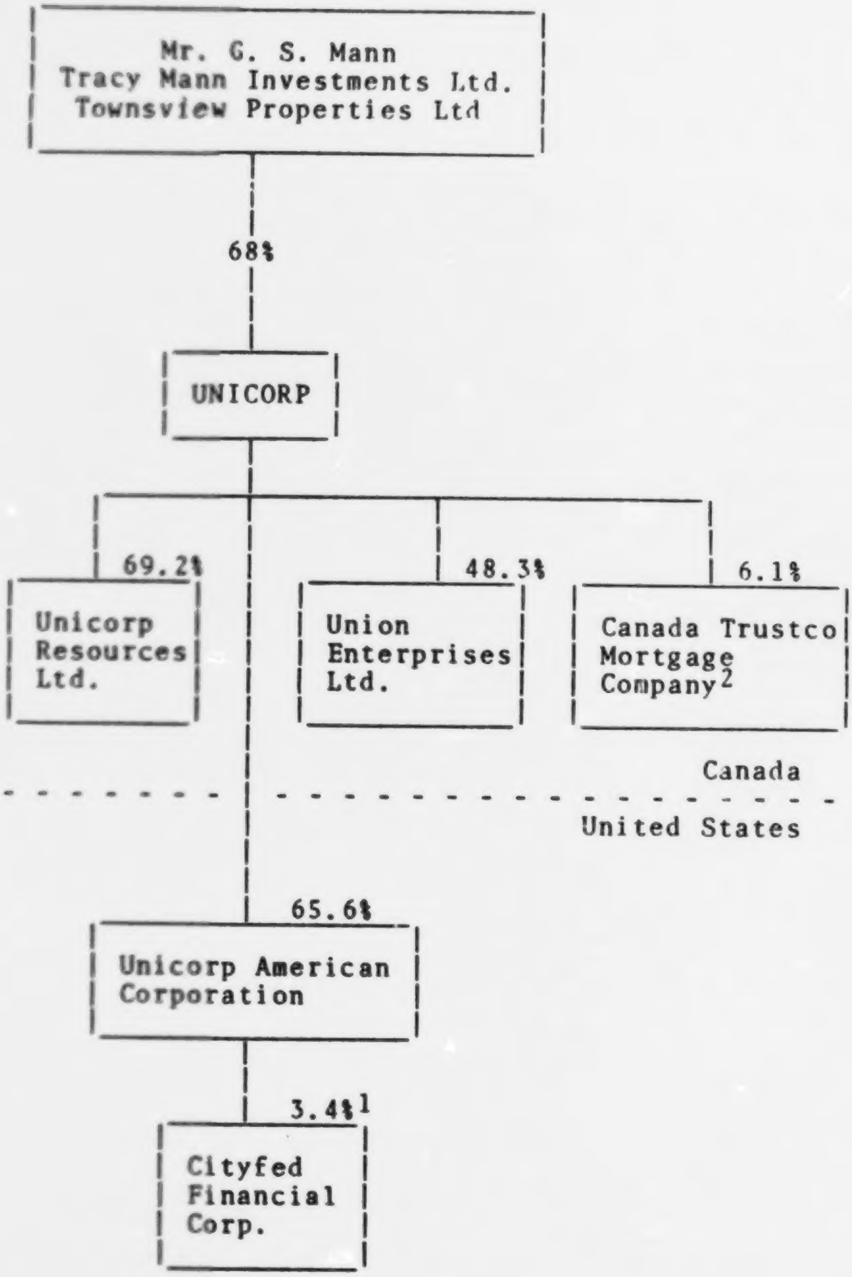
3.28 On March 11, 1985 the date set for the expiry of the takeover offer, Unicorp held 16,200,000 common shares, or 39.5 percent of total outstanding common shares, of Union Enterprises. At that time, Unicorp extended its offer until March 15, 1985.

3.29 When the offer expired on March 15, Unicorp held approximately 19,700,000 of Union Enterprises' common shares worth about $250,000,000, giving Unicorp approximately 60 percent ownership of Enterprises and 48.3 percent of voting control.

3.30 The corporate structure chart which follows depicts the relationship and voting interests between Unicorp and its principal subsidiaries and companies in which it has a significant interest following the takeover of Union Enterprises.

3.31

CORPORATE STRUCTURE OF UNICORP
AS AT APRIL 9, 1985


Mr. G. S. Mann
Tracy Mann Investments Ltd.
Townsview Properties Ltd
68%
UNICORP
69.2%
Unicorp Resources Ltd.
48.3%
Union Enterprises Ltd.
6.1%
Canada Trustco Mortgage Company2
Canada
United States
65.6%
Unicorp American Corporation
3.4%1
Cityfed Financial Corp.

Notes:

1. 8.2% voting interest calculated on a fully diluted basis.
2. This interest has since been sold

The Settlement Agreement

3.32 On March 28, 1985, after the takeover had been accomplished, Union Enterprises and Unicorp reached an agreement which provides Unicorp with representation on the Board of Directors of Union Enterprises to reflect its common share ownership. The Agreement outlined a new voting system on certain types of transactions and placed limits on Unicorp's ability to act as majority shareholder for up to three years in order to preserve the interests of non-Unicorp shareholders. As a result of the Agreement any legal action that had been instigated by either party against the other was discontinued.

3.33 Unicorp entered into the Agreement in order to ensure a visible resolution to what had been described in the press as an "acrimonious" battle for the control of Union Enterprises. Mr. J. W. Leech, the President of Unicorp, testified at the Hearing that the purpose of the Agreement was to get both Union Enterprises and Unicorp executives back to work and thereby allow management to focus on the operations of the respective companies rather than on the takeover bid.

3.34 Mr. W. Darcy McKeough testified at the hearing that Union Enterprises had entered into the Agreement because it alleviated concerns about the potential impact of single-person ownership of the utility and because the Agreement went some distance towards preventing Unicorp from attempting to pay for its acquisition of Union Enterprises from the assets and earnings of the utility. Mr. McKeough indicated that Union Enterprises believed that the Agreement ended the dispute. He also said that any further pursuit of the various legal actions, which had been commenced in an attempt to protect the minority shareholders of Union Enterprises, would hurt the consumers, employees and the remaining shareholders due to the length of time that would be involved in pursuing those legal actions.

3.35 The Agreement is between Union Enterprises and Members of the Selection Committee (described below) on the one hand, and Unicorp Canada Corporation and George S. Mann on the other hand. This rather complex Agreement is summarized as follows.

3.36 **Purpose**: The Agreement establishes Unicorp as the largest shareholder of Union Enterprises and provides minority shareholders with

(i) a significant voice on the Board of Directors of Union Enterprises, and

(ii) protection in the case of substantial transactions undertaken by Union Enterprises and transactions between Union Enterprises and Unicorp.

3.37 **Cumulative Voting**: Cumulative voting is to be established at the next annual meeting of Union Enterprises. Under cumulative voting, each shareholder is entitled to that number of votes equal to his shareholdings multiplied by the number of Directors to be elected. Each shareholder may allocate his votes among the Directors as he or she sees fit.

3.38 **Number of Directors**: The "Minority Shareholders" (those other than Unicorp and its affiliates) shall be entitled to representation on the Board of Directors of Union Enterprises for the term of the Agreement. These are referred to as "Designated Directors". "Other Directors" are, by implication, directors nominated by Unicorp. The proportion of representation is set forth in the following table:

Percentage of Votes Attaching to Unicorp's Securities to Votes Attaching to All Voting Securities	Designated Directors	Other Directors
Greater than 20% but less than 39%	15	9
Greater than 39% but less than 61%	9	11
Greater than 61% but less than 90%	9	15

In no event will the number of Designated Directors or the number of Other Directors (i.e. Unicorp directors) be less than three.

3.39 **Selection Committee**: A Selection Committee drawn from the Board of Directors is established to nominate the Directors who will serve as Designated Directors. The Selection Committee is composed of three individuals on the Board of Directors who are independent of Unicorp. A Unicorp nominee is entitled to be a non-voting member of the Selection Committee. The Agreement contains various provisions dealing with the replacement of members of the Selection Committee. In addition, if a majority of the persons selected by the Selection Committee as their nominees for Designated Directors are not elected by the Minority Shareholders, the members of the Selection Committee must resign. This provision is designed to ensure that the Designated Directors do not perpetuate themselves against the will of the Minority Shareholders. The Designated Directors are authorized to replace vacancies in the Selection Committee or to remove members of that committee who are no longer qualified to serve. Designated Directors must be completely independent of Unicorp.

3.40 **Restrictions on Interested Transactions:**

Union Enterprises may not engage in any interested transaction with Unicorp prior to March 31, 1988, without the prior approval of the majority of the Minority Shareholders, and thereafter without the prior approval of two-thirds of the Directors of Union Enterprises. An interested transaction is defined as:

(a) the provision or obtaining of any financial assistance between any of the Union Group and any member of the Unicorp Group;

(b) any transaction between any member of the Union Group and any of the Unicorp Group... other than a transaction [within the Union Enterprises budget and within certain monetary limits or the disposal of capital assets not exceeding $1 million....];

(c) any amalgamation of any of the Union Group with any Member of the Unicorp Group (other than a member of the Union Group);

(d) [a court-approved arrangement within the

> meaning of the Business Corporations Act, 1982 as a result of which] the protections to the Minority Shareholders as provided in [the] Agreement may be diminished; or
>
> (e) any amendments to the constating documents of any member of the Union Group [as a result of which] the rights and protections of Minority Shareholder...may be diminished.

3.41 **Substantial Transaction:** A substantial transaction may not be undertaken by Union Enterprises without the prior approval of the majority of the Designated Directors. A substantial transaction is one involving property or financial assistance having an aggregate fair market value of $50 million or more, and includes a series of related transactions. This requirement terminates on March 31, 1987, in the case of a transaction involving Burns Foods, and March 31, 1988, in the case of any other transaction.

3.42 **Termination:** The Agreement terminates if a bona fide offer to purchase all the outstanding securities of Union Enterprises is made or if Unicorp acquires 90% of the outstanding voting shares of Union Enterprises. In addition, if prior to March 31, 1988, Unicorp sells substantially all its Union Enterprises shares, the Agreement shall continue to apply to the purchaser of those shares unless it makes an identical follow-up offer to the Minority Shareholders, and such offer is recommended for acceptance by a majority of the Designated Directors.

3.43 **Encumbrance of Unicorp Securities:** During the term of the Agreement, Unicorp shall be free to pledge, mortgage, encumber or create security interests in the Unicorp Securities to secure its *bona fide* debts or obligations to one or more Canadian financial institutions or to secure repayment of debt securities issued by it. Any person acquiring any Unicorp Securities as a result of a realization by a lender, debt holder or person acting on their behalf shall not be subject to the provisions of the Agreement.

3.44 **Amendment:** The Agreement may be amended only if such amendment is consented to by each of Unicorp, George Mann and a majority of the Designated Directors. In addition, the approval of a majority of the Minority Shareholders will be required if an amendment adversely affects the rights and protections of Minority Shareholders under the Agreement.

3.45 The Agreement represented a significant turning point in Unicorp's takeover of Union Enterprises. Although Unicorp had, prior to the Agreement, committed itself to a series of undertakings, it is important to note that the joint undertakings, which are attached as Appendix D-5 in volume II of this report, were prepared by the two parties, Union Enterprises and Unicorp, as part of the settlement negotiations. These undertakings are discussed in Chapter 9.

4. PHASE I ISSUES AS PERCEIVED BY THE PARTICIPANTS

4.1 This Chapter sets out the views of participants at the hearing on the major Phase 1 issues of the hearing. Phase I issues are defined by the Board as those dealing with the specific take-over of Union Enterprises by Unicorp. (Phase II issues, those dealing with the more general aspects of natural gas utility ownership and control, are presented in the next chapter.)

4.2 The major Phase I issues are:

1. The financial strength and stability of Unicorp;
2. The business experience and background of Unicorp and Mr. Mann and his control of Union Gas;
3. The treatment of combined oil and gas interests of the new Unicorp group;
4. The treatment of common shareholders of Union Enterprises;

5. The purchase of Burns Foods;
6. Unwinding the takeover: retroactive legislation.

The Financial Strength and Stability of Unicorp

4.3 There was no suggestion from any participant that the transaction should be interfered with retroactively on the grounds of lack of financial strength in Unicorp.

4.4 Board Counsel submitted that Unicorp's overall financial strength is sufficient to carry the financing costs of purchasing 60 percent of the common shares of Union Enterprises and that, therefore, the purchase should not be interfered with on financial grounds by retroactive or other legislation. In making this submission, Board Counsel assumed acceptance of his or like recommendations respecting Phase II issues.

4.5 In Board Counsel's view, however:

a) Unicorp's existing financial capability is now fully extended;

b) the cash flow from Burns Foods is sufficient to cover the cost of the dividend on the preferred shares issued by Union

Enterprises to purchase Burns Foods. If, however, the projected cash flow proves insufficient, further financial strain might be placed on Unicorp or Union Enterprises and possibly on Union Gas. (Mr. T. R. Close, representing the Chatham and District Chamber of Commerce expressed a similar concern.);

c) there is no sinking fund to retire the $125 million of preference shares issued by Union Enterprises to purchase Burns Foods and provision of the funds to retire these shares could financially strain the Unicorp group; and

d) if Unicorp is required by the Ontario Securities Commission (following completion of its review of the takeover) to offer to purchase the remaining 40 percent of the commons shares of Union Enterprises for $12.50 cash, or more, the financial stability of Unicorp could be changed and weakened by the burden of further financing charges or by the sales of the income-producing properties of Unicorp.

4.6 Mr. Leibel, on behalf of Unicorp, said that given appropriate undertakings or affiliated interest rules, the financial stability of Unicorp does not affect Union Gas. ("Affiliated interest rules" means a code of behaviour applied to a gas utility and its affiliated companies and covers such matters as: loans, indebtedness and investment by the utility, and contracts and transactions between the utility and its affiliated companies.) He pointed out that even a financially strong parent company can become financially weak. Unicorp's view is that financial stability of the parent company is of no long-range value unless proper undertakings or affiliated interest rules are in place to protect the utility.

4.7 Mr. J. Howard, on behalf of Union Enterprises and Union Gas, agreed with Mr. Leibel in disputing Board Counsel's suggestion that Unicorp is fully extended financially. Furthermore, Mr. Howard said that the wall around the utility, comprised of the undertakings of Unicorp/ Union Enterprises and the Agreement between Unicorp and Union Enterprises, form an effective protection for the utility against any adverse impact from the Burns Foods cash flow and share redemption concerns of Board Counsel. Regarding the possibility of an OSC requirement to purchase the remaining 40 percent of Enterprises' common shares, Mr. Howard doubted the likelihood of any such action by the OSC based on present knowledge. Both Mr. Leibel and Mr. Howard agreed that the present transaction should stand but disagreed with Board Counsel in that, in their view, Phase I issues should be dealt with separately from those in Phase II.

4.8 Mr. Ryder, for the City of Kitchener, said that the financial capacity of Unicorp and its intentions with respect to the takeover were, as a result of this hearing, no longer in question.

The Business Experience and Background of Unicorp and Mr. Mann and his Ownership of Union Gas

4.9 Mr. Campion acknowledged that Mr. Mann and Unicorp have an enviable history of business success and steady growth. While this success has been mainly in real estate, Unicorp's lack of experience in running a utility will be offset by the experienced existing management of Union Gas, which is expected to remain. In Board Counsel's opinion, the public review at this hearing has satisfied concern about the history and personality of Unicorp and Mr. Mann and their intentions to maintain a high quality of service and the financial integrity of Union Gas.

4.10 Mr. Leibel said that the issues of concern raised at this hearing relate not to the identity of the owner, or to changes in ownership, but rather result from the structure of ownership (i.e., the chain of ownership from utility to parent company, from parent company to grandparent company and so on).

4.11 Mr. Kawalec, representing certain industrial gas users, opposed the Unicorp takeover of Union Enterprises, and proposed that the holding company should voluntarily divest itself of all but 20 percent of the control of Union Enterprises. This would render undertakings and rules unnecessary, which he regarded as impractical in any case.

4.12 Mr. Poch, for Energy Probe, said that the concentration of control in Union Gas should not be of concern if the proposed affiliated interest rules are enacted and such concentration may indeed be beneficial to customers due to the interest of a major shareholder in the affairs of the utility.

4.13 Mr. Close, for the Chatham and District Chamber of Commerce, opposed the concentration of ownership in the hands of one individual, preferring it to be more widely held. He expressed concern about the speculative nature of Unicorp's activities. Mr. Close suggested that the retroactive legislation referred to by the Honourable Mr. Ashe, the then Minister of Energy, on February 15, 1985, should be introduced requiring that the 20 percent rule of Section 26(2) of the OEB Act be enforced.

4.14 Mr. Mel Swart, in a written brief on behalf of the Ontario NDP Caucus, urged the Board to make a recommendation similar to that of Mr. Close noted in 4.13.

4.15 Mr. and Mrs. La Bombarde, who are individual shareholders in Union Enterprises, also stated that Union Enterprises should hold no more than 20 percent of Union Gas's shares.

4.16 Mr. Tatham, on behalf of the County of Oxford said that a single shareholder should not hold more than 20 percent of the common shares of a utility.

4.17 Messrs. D. and N. McGeachy, on behalf of the McGeachy Charitable Trust, expressed concern that Unicorp's reputation will downgrade Union Gas's credit rating, leading to a higher cost of capital.

4.18 Mr. T. A. Cline, on behalf of the Municipality of Haldimand-Norfolk and the City of Chatham, submitted that the 20 percent rule should be strictly enforced as an ownership restriction.

Treatment of Combined Oil and Gas Interests of the new Unicorp Group

4.19 Board Counsel considered that combining Union Shield with other oil and gas interests of the Unicorp group might put at risk the $104 million preferred share obligation owed by Union Shield to Union Gas. Mr. Campion suggested that, as long as the preferred share interlock remains outstanding in its present form, no change should take place in the existing Union Shield asset base, capital structure or ownership without prior OEB approval. He also said changing the form of the interlock removes a deterrent to Union Gas going to the common equity market if deemed desirable.

4.20 Board Counsel proposed that Union Shield should be monitored by the Board and be reviewed at Union Gas rate application hearings until the preferred share obligation is paid off or refinanced so that Union Gas is no longer at risk. Alternatively, Union Shield should refinance the preferred share interlock, or otherwise pay it off.

4.21 Board Counsel also took the position that Union Gas should be relieved of its guarantee of Precambrian's obligation with respect to $25 million worth of preference shares in Precambrian held by Fiberglas Canada.

4.22 In disagreeing with Board Counsel, Mr. Howard pointed out that before the reorganization of Union Gas, its investment in Numac and Precambrian was in the form of common shares. That interest is now elevated to preferred shares in Union Shield. Union Enterprises will support Union Shield to ensure that Union Shield can pay the dividend and redeem the shares if Union Enterprises' interest in Union Shield drops below 50.1 percent. In any event, the redemption requirement applies also to any accumulated dividend obligation. Specifically, Mr. Howard objected to the requirement that pre-approval of the OEB of any change in Union Shield's asset base or capital structure should be obtained, on the ground that this substitutes the Board's own business judgement for that of Union Shield's management. Moreover, there are no existing criteria for such approval.

4.23 Mr. Howard also stated that there was no need for a new mechanism to monitor Union Shield since Section 27 of the OEB Act already allows the Board, with the approval of the Lieutenant Governor, to ask for information it may require. He said that the problem would, however, remain that the Board would lack the expertise in the resources industry and business judgement to handle the information received.

4.24 Mr. Howard also rejected the alternative suggested by Board Staff of refinancing or paying off the interlock on the grounds that this would raise difficulty regarding the Union Gas dividend, as spelled out in the joint undertaking.

4.25 Mr. P.C. Thompson, on behalf of IGUA, agreed with Mr. Howard in respect of the preferred share interlock as set out above.

4.26 Mr. Poch, for Energy Probe, favoured removal of the preferred share interlock between Union Gas and Union Shield, pointing out that this appears to be an exception to the proposed rule to prevent investment by utilities in unrelated activities or affiliated companies. Moreover, its continued existence may effectively block the utility's access to outside equity.

The Treatment of the Common Shareholders of Union Enterprises

4.27 In Board Counsel's view, the common shareholders of Union Enterprises were not all fairly treated in the context of the takeover bid. He said that:

i) In fact, if not in law, there were two takeover bids in the offering period from February 1 to March 15, 1985 whereby institutions were offered $12.50 or more, in cash, for their shares while individual shareholders were not. Individual shareholders were able to get such a price only if they had a detailed knowledge of the operations of the market, or were simply lucky. Demand for the shares was insufficient to support a $12.50 price if all shareholders had offered their stock for sale through the offering period via the stock exchange.

ii) All of the institutions and 90% of the clients for whom Gordon Capital acted received $12.50 or more for their shares.

iii) As of April 9, 1985 almost all of the remaining shareholders of Union Enterprises were non-institutional shareholders.

iv) Many shareholders of Union Enterprises were disadvantaged by the Union Enterprises campaign against the Unicorp bid. In the opinion of Board Counsel this negative campaign, in conjunction with the market system, resulted in unfair treatment of many of Union Enterprises' common shareholders. The only major purchasers of Unicorp's preferred shares, other than the Edper/Brascan group, were financial institutions connected to Unicorp, and Olympia and York Developments Limited. The last was the only major independent purchaser of Union Enterprises shares subsequently tendered into the Unicorp offer.

4.28 Nevertheless, in Board Counsel's view, the evidence indicates that there was no concerted effort by the Edper/Brascan group to make the takeover bid successful. It appeared to Board Counsel that since this group is prominent in the preferred share market (as is Gordon Capital), its leadership in purchasing the Unicorp preferred shares may have had a positive effect on others.

on others.

4.29 In Board Counsel's view, the Board can do no more than draw the unfair treatment of shareholders to the attention of the Lieutenant Governor.

4.30 Mr. Leibel, for Unicorp, disagreed strongly with Board Counsel. In his view, a finding of unfairness would require a thorough knowledge of the Ontario Securities Act and an investigation of the law and regulations. Mr. Leibel said that there had been no evidence submitted at this hearing by any witness involved in the takeover as to the fairness of the bid. He also stated that not only would such a finding amount to a major breach of natural justice, but it would also hamper Unicorp's efforts to restore public confidence in the utility which was the major purpose of the efforts to resolve the hostilities between Unicorp and Union Enterprises. Mr. Leibel said that, in any event, such a finding of unfairness would be untrue in that there was only one takeover bid which was made to all shareholders by Unicorp. In Mr. Leibel's view, the matter of the treatment of shareholders should be left to the Ontario Securities Commission which, he said, is currently investigating the takeover.

4.31 Mr. Howard agreed with Mr. Leibel that the Board should not do anything based on incomplete evidence on the unfairness issue. He saw the real problem, which the OSC must decide, as whether, in the context of the Ontario Securities Act, there was a pattern of buyers acting in concert. The Board's concern, according to Mr. Howard, is not to protect the shareholders *per se*, but to concern itself with any adverse situation impacting on shareholders or potential shareholders, which may result in an increased cost of capital and, in turn, affect customers' rates. Mr. Howard agreed that there is a need to restore confidence in the utility.

4.32 Mr. Thompson agreed that questions relating to any unfair treatment of the common shareholders of Union Enterprises should be left to the OSC and/or the Courts to resolve. He commented that the OEB has no obligation to protect the marketability of shareholders' shares.

4.33 Mr. Poch also agreed that the question of fairness of the treatment of shareholders should be left to the OSC.

4.34 Hiram Walker Resources, represented by Mr. Campbell, supported IGUA's contention that shareholder interests are protected by the workings of the marketplace, as well as by the provisions of the Ontario Business Corporations Act and the Ontario Securities Act. The Ontario Energy Board has to do no more, he stated, than be mindful in its ongoing regulation of the effect of any activity in its jurisdiction on the shareholders.

4.35 Mr. Paddon, for Consumers' Gas, referred to the duties and responsibilities of corporations, directors and officers as prescribed under the Ontario Business Corporations Act; in his view, no additional legislation is necessary to protect the interests of shareholders and debt holders.

4.36 Mr. and Mrs. La Bombarde as shareholders in Enterprises, believed that there had been unfair treatment of shareholders.

4.37 Messrs. D. and N. McGeachy felt that, as minority shareholders, they were treated unfairly in that major institutions were able to obtain cash for their shares but individual shareholders were required to accept non-voting preferred shares.

The Purchase of Burns Foods

4.38 In Board Counsel's view, this purchase by Union Enterprises was inappropriate, within the context of the takeover bid, in that the Board of Directors of Union Enterprises - the majority of whom agreed to this large transaction, which fundamentally altered Union Enterprises' structure - failed to obtain shareholders' consent to it.

4.39 Mr. Leibel, for Unicorp, said that while the Burns Foods transaction was highly controversial and may have indirectly assisted the takeover of Union Enterprises by Unicorp, the transaction should not be of great concern to the Board. He contended that the timing of the Burns Food purchase was directly connected to Unicorp's takeover bid and obstructed its bid, but that Union Enterprises received good value.

4.40 Mr. Howard agreed that it would be inappropriate for the Board to express any opinion since there had been no examination in law. He also said that the OSC has been reviewing its policy as to conduct during takeover bids since 1983. There was, in his view, nothing illegal about not obtaining shareholders' consent. In any event, the Burns Foods purchase had no potential impact on the utility because of the existence of the Agreement and the undertakings by the parties. Mr. Howard said that the question should be left to the OSC, not to the Lieutenant Governor.

Unwinding the Takeover: Retroactive Legislation

4.41 As earlier noted there were some references to the 20 percent rule (although inapplicable to holding companies under Section 26) being enforced in this case, and to the introduction of retroactive legislation. As well, Mr. Kawalec proposed that Unicorp should voluntarily divest itself of all but 20 percent of the control of Union Enterprises failing which retroactive legislation to achieve this should be introduced. There were few other suggestions that the takeover transaction should not be allowed to stand.

4.42 Mr. Kawalec further suggested that in one year's time another hearing be held to deal with the divestiture by holding companies of Consumers' and Northern and Central, as part of public policy.

4.43 Board Counsel suggested that with the context of recommendations relating to Phase II issues the Board ought to report to the Lieutenant Governor that the acquisition by Unicorp of the voting control of Union Enterprises and therefore the control of Union Gas, has no probable or potential negative impact:

i) on the storage, transmission and distribution business and activities of Union Gas;
ii) on the present and future customers of Union Gas, in terms of both service and rates;
iii) on those who contract with Union Gas for storage or transmission services; and
iv) on energy supply in Ontario.

5. PHASE II ISSUES AS PERCEIVED BY THE PARTICIPANTS

5.1 This chapter sets out the views of the participants at the hearing on the major Phase II issues of the hearing. Phase II issues are defined by the Board as those dealing with the more general aspects of natural gas utility ownership and control which have been raised by the takeover of Union Enterprises by Unicorp.

5.2 The major Phase II issues are:

1) Review of direct and indirect utility ownership and control;
2) Issues relating to undertakings, rules and legislation;
3) Other issues raised by the takeover.

Review of Direct and Indirect Utility Ownership and Control

5.3 Board counsel took the view that a review of ownership and control of a utility as reflected in Section 26(2) of the OEB Act ought to be retained. There are positive reasons for imposing a pre-acquisition approval process and, in Mr. Campion's opinion, government interference in the market for corporate control of a utility is not an adequate reason to oppose this type of review. Further, the Lieutenant Governor and the OEB ought to be advised, as a requirement, of any known possible or probable change in ownership or control of a holding company owning a utility. This would allow the Lieutenant Governor to apply Section 36 of the OEB Act if a public review was considered necessary or Section 35 if an exemption from a public hearing was considered appropriate.

5.4 Mr. Leibel, for Unicorp, said that the establishment of a single set of generally applicable rules, determining the conduct between a utility and its affiliates, would result in no negative impact on gas consumers and would obviate the need and desirability for public review of direct or indirect ownership or control of gas utilities. Unicorp considered that it would be a reasonable requirement that the Minister of Energy be notified of changes in control of a utility, simply by means of advising him of material information, that is, without necessarily taking any action.

5.5 Mr. Leibel saw the problem of ownership of a utility was one of the structure of ownership, rather than its change.

5.6 Mr. Leibel considered that there is no economic reason for preventing the concentration of the gas distribution industry in the hands of one entity. If, however, the Government of Ontario believes that such concentration should be prevented, a general prohibition against the acquisition of one utility by another could be introduced into the OEB Act.

5.7 Unicorp also considered that there is no need for concern about the concentration of the ownership of a particular utility in the hands of one person. In fact, a single owner with a proprietary interest in the utility has a strong incentive for ensuring that it is well managed and efficient.

5.8 In Unicorp's view, pre-acquisition approval of utility ownership does not resolve the issues arising from the structure of ownership. The circumstances and intentions of the owner could change after pre-acquisition approval had been given.

5.9 Pre-acquisition approval is seen by Unicorp as a detriment to the utility since this reduces the transferability of ownership and control of the utility which, in turn, has the effect of increasing the cost of capital by making its shares less attractive. The requirement of a pre-acquisition approval would also reduce the pressures on the utility for efficient management. Further, it would be extremely difficult to decide what the criteria for approval or non-approval should be.

5.10 In Unicorp's view, the real problem is the potential exploitation of the utility by its parent, which has nothing to do with change of ownership but everything to do with the fact that the utility has a parent. Resolution of this problem should be ongoing, rather than focussed on a particular resolution at the time of a change in ownership. The problems arise from the need to protect the utility from any adverse effects of utility diversification, or from the holding company structure, or from transactions between the utility and affiliated companies.

5.11 Unicorp believes that there is no need for, or desirability of, the public review and regulation of the direct and indirect ownership and control, and transfers thereof, of gas distributors and transmitters in Ontario and that Section 26(2) of the OEB Act should be repealed.

5.12 Mr. Howard pointed out that Section 26(2) of the OEB Act does not deal with control, but paragraph 2 of the Order in Council asked the Board to consider control. If the Board concludes that ownership and control is a matter of public interest, then the wording of Section 26 should, in Mr. Howard's opinion, reflect that.

5.13 In defining control, Mr. Howard said there were no logical grounds for stopping at any particular point in the chain of ownership and if Section 26 is to be changed there should be no provision to limit the enquiry to the first level of control. Changes in control should be examined prior to the event to ensure that the change will not have an adverse impact on customers. This examination will establish whether there is an effective wall around the utility (by way of agreement, and undertakings) assuring that control cannot be misused to the detriment of customers. In Mr. Howard's view, it is preferable to establish this examination prior to the event, rather than depend on a code of conduct, eliminate hearings, and lose flexibility.

5.14 Mr. Howard proposed that Section 26 be amended as follows:

> 26(2). Without first obtaining the leave of the Lieutenant Governor in Council, no person, either alone or together with one or more associates of such person, shall acquire control of a gas transmitter, gas distributor or storage company.
>
> 26(2)(a). In this section, "control" means direct or indirect control in fact by any means whatsoever, including, without limitation, by means of contractual rights, by means of business relationships or by means of the holding of securities; and in addition the direct or indirect holding by any person, either alone or together with one or more associates of such person, of securities of a corporation, partnership or trust to which are attached more than (20%) of the votes attached to all outstanding securities of such corporation, partnership or trust shall be deemed to be control of such corporation partnership or trust.

5.15 Mr. Paddon, on behalf of Consumers' Gas, believed that no control was necessary over direct or indirect ownership. He proposed that Section 26(2) of the OEB Act should be removed. Consumers' favours the unrestricted trading of gas utility securities, not because this influences economic efficiency, or has a direct impact on the efficiency and entrenchment of management, but because freely tradeable securities keep the cost of capital down.

5.16 Mr. Poch, for Energy Probe, stated that a "universal rules" approach to regulating ownership and control of gas utilities is preferable to that of "ad hoc" review. The Board must, however, retain flexibility to deal with changes in circumstances. A fence of universally applicable rules should be built around the utilities to make the customers largely indifferent to ownership. Such rules will provide a signal to the public that they need not fear changes of utility ownership or control. This approach will also avoid the need for lengthy hearings in every case of ownership change.

5.17 Mr. Ryder, for the City of Kitchener, said that there was a need for, and desirability of, reviewing and regulating the transfer of ownership to the extent that transfers could result in change of control. The preacquisition approval process protects the public interest. Mr. Ryder said that the case for the free exchange of assets as a means of purging inefficiencies and improving earnings has, in his view, been overstated. The prospect of enhanced earnings and capital gain is substantially inapplicable to a regulated utility, in

Mr. Ryder's view, because earnings improvements result in a reduction in the revenue requirement. Mr. Ryder said that the evidence indicates that purging inefficiencies in Union Gas was not a factor in the takeover by Unicorp of Enterprises.

5.18 Mr. Ryder said that pre-acquisition approval has the advantage of avoiding retroactive divestiture. The pre-acquisition approval process should be applied to direct and indirect purchases and not be limited to the first or second holding company level; the intricacies of holding companies must be examined. Mr. Ryder accepted Mr. Howard's draft of Section 26.

5.19 The pre-acquisition approval hearing should be before the OEB, Mr. Ryder stated. The Board would make a recommendation for the Lieutenant Governor's decision which, when made, would be filed with the Board and enforcible as an Order of the Board. There should be no exception in the hearing requirement, in Mr. Ryder's view.

5.20 Mr. Ryder said that while the takeover bid could be made, the bid could not be accepted until after the Lieutenant Governor had made his decision.

5.21 Mr. Roland, for Inter-City, said that there is no need for the public review of transfers of ownership and/or control except perhaps for the horizontal concentration of ownership. He suggested that Section 26(2) of the OEB Act be repealed, or amended to leave the preacquisition approval process only for the horizontal concentration of ownership. He said that if this is a concern from a political viewpoint, the pre-acquisition approval process should be retained in the event that a gas utility, or an associate, proposes to purchase a significant interest in another gas utility, or its associate. While the Board should not be concerned with the ownership and control of utilities, if it chose to be so concerned then its review should go to the ultimate source of control. However, in his opinion, there is no logic to protecting the utilities only when there is change of direct ownership and control. In his opinion, there is sufficient regulation of the relationship between owners and the utility without Section 26(2) and the Board has sufficient expertise, in relation to its existing powers of regulation, to protect the public interest in the event of a change of direct or indirect ownership or control.

5.22 It was Inter-City's position that the pre-acquisition approval process, if undertaken, should not be concerned with the personality and character of the proposed owner. Further, Mr. Roland regarded it as fallacious that any assistance is gained by public examination of the intentions of the proposed owner. At best, intentions can be translated into undertakings. While there may be some comfort level to the public in the pre-acquisition approval process, the balance of benefits versus detriments indicates, in Mr. Roland's view, that the price is not worth the aggravation.

5.23 He said that if protection of the utility is considered desirable in the event of direct or indirect change in ownership, then this should be accomplished by undertakings, as required by the Lieutenant Governor on the advice of the Board, from the utility and its parent. Mr. Roland pointed out that the pre-approval process has resulted in undertakings from the owners of the three major Ontario gas utilities with respect to each utility. Section 26(2) is not needed to protect the public interest, in Inter-City's view, taking account of the Board's other powers. In any event, undertakings themselves are unnecessary, in Inter-City's opinion, since a prudent owner with a substantial investment in a utility will not behave in a manner which will impair this investment, i.e., he will always act consistently with undertakings in any event. Contrary behaviour would result in unfavourable regulatory treatment and impairment of the owner's investment. The Board has sufficient powers to deal with any problems in the relationship between the utility and the owner.

5.24 Mr. Roland said that the existence of Section 26(2) causes uncertainty associated with the pre-acquisition approval process which could well prevent a takeover bid; this would be contrary to the public interest in that a free exchange of ownership and control of capital assets is in the interest of the public. Mr. Roland agreed with Mr. Howard that Section 26(2) does not really deal with control.

5.25 Mr. Thompson, on behalf of IGUA, said that there is a need for public review and regulation of direct and indirect ownership and control and transfers thereof, because of potential owner/controller-related abuses and possible poor management of a utility arising from the relationship between the utility and the owner/controller. IGUA favours pre-acquisition approval as an option available to the acquirer, but not mandatory upon it i.e. IGUA is not in favour of banning the transfer of ownership of utilities or of holding companies that own a utility without pre-acquisition approval.

5.26 Mr. Thompson said that the purpose of review is to impose constraints to prevent abuses. Ongoing scrutiny is to monitor and enforce compliance thereafter. The spirit and intent of the present Section 26(2) supports the conclusion that public scrutiny by the Lieutenant Governor, following notice of change in ownership, is required, whether or not the OEB assists the Lieutenant Governor under Section 36.

5.27 The framework for future review and regulation should be changed and improved, said Mr. Thompson, because currently:

- the Lieutenant Governor is the sole scrutineer who can act with or without assistance of the OEB;
- Section 26(2) requires a public hearing by the OEB and a report to Lieutenant Governor;
- Section 35 allows exemption from a public hearing;
- Section 36 allows reference to the OEB; and
- ongoing review and regulation rests with the OEB.

5.28 He suggested that Section 26 of the OEB Act be amended as follows:

- Section 26(1) The reference to the Lieutenant Governor should be removed and the OEB substituted.
- Sections 26(2) and (4) should be replaced by the following new sections:
  - (i) The direct and indirect ownership and control of gas distributors and transmitters and transfers thereof shall be subject to review and regulation by the OEB.
  - (ii) Any person who acquires or plans to acquire direct or indirect ownership and control in a gas distributor or transmitter in Ontario shall immediately apply to the OEB for an Order approving the acquisition and the Board shall hold a public hearing.

In IGUA's view, the words "or plans to acquire" give the acquirer a pre-acquisition approval alternative, i.e. without making pre-approval mandatory upon the acquirer.

5.29 In future, all review and regulation of transfers of ownership should rest with the OEB, according to IGUA; there should be no exemptions from public hearings and the OEB should scrutinize, monitor and enforce. The OEB should have powers to impose constraints and to enforce compliance of its own orders. Such powers already exist in the OEB Act, according to Mr. Thompson.

5.30 Mr. Campbell, representing Hiram Walker, said that the pre-acquisition approval of a change of ownership is unnecessary as it interferes with the capital markets. For this reason, as well as that of expediency, Hiram Walker favours the retention of the exemption provision of Section 35 on the basis of undertakings given. Any change to conditions, such as change in ownership, provides the opportunity to the Lieutenant Governor under Section 36 to refer the matter to the Board for review; this fact, together with the power of the Board to promulgate its own rules under an amended Section 27, would obviate the need to further regulate the free transfer of shares.

5.31 Hiram Walker would leave Section 26 unchanged, with its 20 percent provision in respect of the number of shares of a utility concerned in the transfer, as an appropriate trigger for review. Regarding transfer of ownership of the holding companies, Mr. Campbell said that the provision in the Unicorp/Union Enterprises joint undertaking to provide notification to the Lieutenant Governor of a change would set in motion the appropriate mechanism for review.

Issues Relating to Undertakings, Rules and Legislation

5.32 The subjects covered in this section include:

- undertakings and their monitoring and enforcibility;
- legislation requiring pre-approval for utilities to issue securities; to pay out dividends; to incur indebtedness, to make loans and investments in non-utility areas; and to diversify within the utility;
- information regarding financial arrangements between utilities and affiliates;
- affiliated transactions;
- notification of change of control/ ownership; and
- independence of a utility's Board of Directors;

5.33 Mr. Campion pointed to the inconsistencies in the respective undertakings of the owners of Ontario natural gas utilities. He referred also to the fact that none of the undertakings addressed the functional area of contracts and transactions with affiliated entities. While it had been suggested that such transactions should be monitored and enforced through ongoing regulation by reviewing them *ex post facto* at rate hearings, Mr. Campion pointed out the difficulties that would arise from attempting to change the situation, after the event, if the conclusion of the review proved unfavourable.

5.34 Mr. Campion stated that existing undertakings are not monitored consistently.

5.35 Regarding enforcibility of undertakings, while the industry considered them to be enforcible or binding, Mr. Campion said that the difficulty of enforcement arises from their legal nature as agreements between contracting parties. Indirect enforcement via a rate case may not prove satisfactory. Direct enforcement, e.g. in the case of a flagrant breach of an undertaking, could only be through the courts or through legislative action. In the former, legal questions, such as whether consideration existed to support a contract, are a possible defence against enforcement. In Mr. Campion's opinion, legislative action cannot be relied upon as a means of regular enforcement of undertakings. In the case of a flagrant breach, enforcement is cumbersome and difficult.

5.36 Furthermore, Mr. Campion raised doubts as to the Board's legal right, as part of the process of monitoring undertakings, to review a utility affiliated company which is not subject to regulation and not itself under any obligation by reason of the undertakings given.

5.37 In Mr. Campion's view, breach of undertakings could only be directly punished by mandatory injunctive relief, or by denying a portion of the return component in the cost of service, in a future rate case. This latter alternative would, Mr. Campion suggested, ultimately raise the cost of capital to the utility and harm the customers. Moreover, denial of a fair return in punishment for the breach of an undertaking may raise doubts as to the Board's legal authority. As well, Mr. Campion felt that the punishment could compound the original breach, particularly if the latter had damaged the utility's financial position. The ability to punish would not exist if, for example, a one-time dividend payment had extracted capital from the utility.

5.38 Mr. Campion suggested that one effective solution to the problem of enforcibility is to explicitly authorize the Board to consider certain matters before they occur. He suggested that gas utilities ought to be required by legislation to obtain pre-approval of the OEB to:

i) issue securities (in respect of the mix of securities only, not in respect of timing or rate to be paid, which is a matter of ongoing regulation);

ii) pay out dividends in excess of 100 percent of earnings in any given year;

iii) incur indebtedness, loans and investments in non-utility areas especially to affiliates, "affiliates" being widely defined; and

iv) diversify further within the utility.

5.39 As well, Mr. Campion proposed that legislation should provide the OEB with the right to have access to all information relating to affiliate companies which owe money by way of preferred shares or other obligations to the gas utility, so long as such financial obligations remain outstanding. All affiliate transactions should be required by legislation to be disclosed to the OEB in every rate case, and information provided to facilitate regular monitoring. Legislation should require notification to the OEB of any change in control or ownership of a gas utility, and would permit the OEB to take steps to maintain the independence of the utility's Board of Directors, of whom 40 percent should reside in the franchise area.

5.40 Mr. Leibel considered that the joint undertakings of Unicorp/Union Enterprises are fundamental to the well-being of Union Gas and are sufficiently protective of the utility that the health, intentions, and even the existence of the parent company become irrelevant. It is Unicorp's belief that all of the past undertakings (including those relating to Hiram Walker/Consumers' and Inter-City/Northern & Central) are valid and enforcible contracts in law, being enforcible in the courts at the suit of the Lieutenant Governor. In addition, in Unicorp's view, the Board has considerable power to ensure compliance with undertakings.

5.41 With respect to the joint undertakings, Mr. Leibel believes enforcibility would be assured if they were executed under seal. (Mr. Howard later supported this contention).

5.42 Mr. Leibel said that he would not object to a requirement that the utility file reports regularly with the Board respecting the fulfillment of undertakings or affiliated interest rules.

5.43 Mr. Leibel said that Unicorp feels strongly that rules concerning the takeover of a utility must be clearly set out in advance. Unicorp believes that the dual objectives of certainty and flexibility would be addressed by:

- the elimination of rules where none are required,
- the promulgation of strict and clear rules where they are required, and
- the promulgation of rules allowing for exemptions, with the rules containing criteria for granting exemptions.

5.44 Regarding the enforcement of rules, Mr. Leibel suggested that:

i) the OEB Act be amended to permit the passing of regulations by the Board to govern affiliated interests;
ii) that such regulations be passed;
iii) that the OEB Act contain penalties for breach of these regulations.

These changes would make the rules fully enforcible, in Mr. Leibel's view.

5.45 Mr. Leibel said that Unicorp would have no objection to a general rule requiring portions of current and future utility earnings be retained in the utility, as may seem appropriate to the Board. However, Unicorp pointed to the Board's practice of requiring the maintenance of an equity level through ongoing regulation, and also to the provisions of the Ontario Business Corporation Act in respect to the responsibilities of Directors in regard to the payment of dividends.

5.46 Unicorp is opposed to the Board's pre-approval of share and debt issues by the utility. Mr. Leibel argued that a pre-acquisition approval requirement would destroy the utility's flexibility as to timing of the issue and that, in any event, the Board is not in a position to judge the appropriateness of a particular capital issue, that being the prerogative of management. Unicorp believes that the Board has sufficient opportunity to express any views on capital issues through consideration of capital expenditure and capital structure during rate applications.

Unicorp considered that transactions by affiliated companies should be controlled by rules or undertakings that ensure that the utilities are not exploited. Affiliated interest rules, Unicorp believes, would effectively resolve the concerns arising from the holding company structure of ownership. They would apply to all owners and to all affiliates of the utility and would address the relationship between the utility and its affiliates, on an ongoing basis. This is seen by Unicorp as the real issue.

5.47 In Unicorp's opinion, affiliated interest rules are preferable to undertakings. While all three major Ontario gas utilities are now subject to similar undertakings, there are advantages, Unicorp believes, to having affiliated interest rules:

i) the utilities would be subject to identical rules, obviating differences in interpretation of undertakings;

ii) rules would obviate the need for a new set of undertakings if there was change in ownership or control of the utility;

iii) while undertakings are believed enforcible, any doubt would be removed by the incorporation of rules in the legislation; and

iv) such rules would make certain the responsibilities and obligations of future owners towards the utility.

5.48 Unicorp believes that the form of the Unicorp/Union Enterprises joint undertakings should be accepted by the Lieutenant Governor and no further action in respect of the Unicorp transaction should be taken.

5.49 Unicorp proposed that generally applicable affiliated interest rules governing the relationship between utilities and their affiliates should be introduced into the existing legislation. Specifically Unicorp suggested that Section 35(1) of the OEB Act should be amended to give the Lieutenant Governor the power to make regulations regarding the relationship between utilities and their affiliates. Further, regulations should be introduced pursuant to Section 35(1), as amended, to establish such affiliated interest rules; and new provisions should be introduced to provide for penalties in the event of breach of such rules.

5.50 Unicorp believes that undertakings and rules are effective because:
i) they are enforcible;
ii) the utilities are subject to moral suasion; and
iii) they can be reviewed in the regular rate hearings.

5.51 Unicorp pointed to the fact that diversification is already a fact of life in Ontario's natural gas industry. The company believes that regulation would be facilitated if, as a general rule, non-utility businesses were carried on by the holding company or by nonregulated affiliates. However, any rule prohibiting diversification by a utility should be capable of admitting exceptions so that, in appropriate circumstances, the utility could carry on the non-regulated business itself.

5.52 The joint undertakings of Unicorp and Union Enterprises provide for an independent Board of Directors of Union Gas. A majority of that board will be selected by those directors of Union Enterprises who are elected by the minority shareholders of Union Enterprises. In its own original undertakings, Unicorp had offered to create an independent Board of Directors of Union Gas so as to establish Unicorp's intentions with respect to the operation of the utility. Unicorp stated that it is not particularly concerned with a requirement for an independent Board of Directors for Union Gas; in Unicorp's view, it is likely that such an independent Board is unnecessary, given the protection afforded by undertakings and affiliated interest rules.

5.53 Mr. Howard, for Union Enterprises/Union Gas, submitted that flexibility to meet changing circumstances and to deal with particular cases is more important than certainty. He doubted that a code enshrined in regulation would lead to certainties; there will be exceptions requiring hearings which, in turn, will require criteria such as those in the present Order in Council and the Board's procedural orders.

5.54 In Mr. Howard's view, confusion has arisen because of fear of the effect of a breach in the undertakings, in that curing the breach would result in an increased cost of capital and harm to the customers. There is, in his opinion no difference between a breach of undertakings and a breach of codified regulations insofar as enforcement is concerned or in respect of any adverse effect upon customers. Codification is not the way to go, in Mr. Howard's opinion.

5.55 Union Enterprises/Union Gas take the view that pre-acquisition approval of dividends, share issues etc. by the Board, as proposed by Board Counsel, involves the Board in the management of the utility, rather than regulation. This would tend towards public ownership, not private enterprise.

5.56 Mr. Howard pointed out that the mix of securities is already effectively within the Board's purview because of the use of a prospective test year in rate cases. Regarding dividend payout, Mr. Howard referred to the undertaking restricting the maximum dividend payment of Union Gas for the next three years. In respect of the potential for double leverage of the utility, he argued that the Board can substitute a hypothetical capital structure for the actual. In respect of loans and indebtedness, Mr. Howard believes that the structure of undertakings and agreements permits review on a case-by-case basis which is preferable to a requirement for pre-acquisition approval by the Board.

5.57 As far as diversification by the utility is concerned, whether through divisions or subsidiaries, Mr. Howard submitted that this should be left to management. The Board has the ability to amend the situation, as it considers appropriate, at the time of rate hearings.

5.58 Mr. Howard said that there was no need for new legislation giving the OEB the right to have access to information relating to affiliated companies. Section 27 of the OEB Act provides the Board with any power needed and the practice of interrogatories during a rate case provides the means to obtain information concerning affiliated transactions.

5.59 In Mr. Howard's view, notice of a change in ownership by itself does nothing and is generally too late. He saw difficulty in seeking to impose a requirement upon the utility regarding the composition of its Board of Directors. In his opinion this could be offered by way of an undertaking, but to seek to impose it, may not be within the Board's jurisdiction.

5.60 Mr. Thompson, for IGUA, submitted that review and regulatory powers should be used to prevent owner-related abuses of the utility with particular concern for:

i) dividend policy;
ii) share issuance and indebtedness;
iii) affiliate transactions;
iv) diversification;
v) Board of Directors composition;
vi) Head Office location; and
vii) common share float.

5.61 Mr. Thompson suggested that these constraints should be imposed by Order of the OEB. He submitted that there was no need for rules when there are only three major utilities, each controlled by a holding company, particularly if, upon review, company-specific constraints need to be added to those imposed by the rules. The OEB's Order can, Mr. Thompson said, include both company-specific and standard constraints.

5.62 Mr. Thompson said that, in respect of dividends, IGUA supports the standard set out in paragraph 2 of the 1984 Order in Council to Inter-City, namely, that dividends should not be such as to reduce shareholders' equity except as may be consistent with applicable statutes, trust indentures and OEB findings as to appropriate levels of equity. He said that pre-screening of share and debt issues is not supported by IGUA.

5.63 IGUA agrees with the standard set out in paragraph 3 of the Order in Council to Inter-City which says that Northern & Central shall not be responsible for the indebtedness of, or make loans or advances to its parent or affiliates. Although diversification contradicts the stated purpose for the Union Gas reorganization in respect of standing alone, IGUA sees no need to restrain diversification by the utility except for expressing a preference that it should be conducted through a corporate entity other than the utility. IGUA believes in an independent Board of directors for the utility.

5.64 Regarding transactions with affiliate companies, IGUA held the view that without the approval of the OEB, a gas utility should be prohibited from buying gas from an affiliate. If the utility were to buy gas from its own affiliate, it might, because it has no obligation to carry another party's gas, effectively block the purchase of gas by an end-user from the end-user's own affiliate.

5.65 Mr. Thompson proposed that the OEB should monitor and enforce future undertakings and that the Board should act by Order on the strength of parts of Sections 13, 14, 27 and 29 of the OEB Act. He contended that under Section 27(1)(a) the Board has power to make regulations subject to the approval of the Lieutenant Governor. He suggested, however, as a remedy of last resort in the event of noncompliance, the ordering of divestiture of the owner's controlling interest.

5.66 In IGUA's view, monitoring and enforcing of existing undertakings, including those applicable to Inter-City/Northern & Central and Hiram Walker/Consumers' should be brought under the OEB's auspices by assignment from the Lieutenant Governor: this to be accomplished by legislative changes or Order in Council.

5.67 Mr. Poch said that Section 27 of the OEB Act can be amended to broaden the OEB's monitoring power and also be used by the Board to require utilities to report, in advance, proposed dividends, and equity or debt issues, to allow the Board to call a hearing if deemed necessary. The Board should, in his opinion, have the power to block a dividend or capital issue.

5.68 Mr. Poch also said that Energy Probe favoured diversification only at the holding company level.

5.69 Mr. Ryder said that all the existing undertakings should be made enforcible either by assignment, as suggested by Mr. Howard, or on application or motion of an interested party, including the Board, customers, or shareholders. Future undertakings would not be necessary, according to Mr. Ryder, because they would take the form of an Order of the Board, if conditions were attached to the Lieutenant Governor's approval.

5.70 Mr. Ryder said that, given the major Ontario gas utilities' present level of maturity, earnings of a utility not required to be retained should be paid out as dividendeds for reinvestment in a diversified business, but that it should be carried on by a separate corporate entity, not by a subsidiary of the utility.

5.71 Mr. Ryder commented that undertakings are significant in that they represent the degree of regulatory interference that owners of holding companies have come to accept.

5.72 Mr. Ryder believed that general undertakings, i.e., those appropriate to the industry as a whole, may properly be legislated but cautioned that care should be taken to avoid legislating for decisions that normally belong to management. Mistakes, he said, should be made by management, not by the Board which must retain its authority to exercise 20/20 hindsight and to second guess.

5.73 A utility should not acquire non-utility assets without Board approval, in the opinion of Mr. Ryder. Board approval is necessary also, he said, for loans to other companies whether or not they are evidenced by bonds or preferred shares.

5.74 Mr. Ryder said that, with respect to dividends, the three year limitation already in the Unicorp/Union Enterprises joint undertakings should not be legislated but, with respect of ongoing dividends, legislation should limit dividends so as not to reduce or alter the capital structure.

5.75 Mr. Ryder also contended that Board approval should be required before a utility incurs obligations of indebtedness of any related company including subsidiaries.

5.76 Affiliated contracts, in Mr. Ryder's view, are already covered by ongoing regulation.

5.77 Mr. Ryder said there was no need for Board preapproval of the utility's security issues made in the normal course of financing of its enterprises.

5.78 On behalf of Hiram Walker, Mr. Campbell stated, regarding undertakings, that the Board can require the utility at anytime (not necessarily in a rate case) to report to it on the state of the undertakings and, by so doing, bring the parent before the Board to account for its stewardship. Hiram Walker believes there is no need, in this context, to anticipate abuses of undertakings. It regards the undertakings in relation to Hiram Walker and Consumers' as binding, regardless of who owns Hiram Walker.

5.79 Mr. Campbell stated that Hiram Walker believes that no changes to existing legislation are necessary in respect of monitoring and enforcement. However, it might be of assistance if any impediment to the Board making its own rules and regulations be removed e.g. by changing Section 27 as necessary.

5.80 Hiram Walker is not in favour of rules restricting securities issued, or dividends declared by the utility.

5.81 Mr. Paddon, on behalf of Consumers', said that there had been much theory and dogma put forward in this hearing but no hard evidence requiring legislated remedies. Consumers' believes that undertakings are sufficient and there is no need for rules, legislation or regulation. He stated that the OEB has very broad powers, including those of the Energy Returns Officer, and it can easily handle monitoring of undertakings. Mr. Paddon referred to the Divisional Court's confirmation of the Board's powers in its decision denying an application by Unicorp asking the Court to find that the Board had gone too far. Mr. Paddon also referred to the powers given the Board under Section 27 of the OEB Act.

5.82 Consumers' considers that whether or not the undertakings are legally binding is academic. The Board can undoubtedly monitor the compliance with the undertakings and, through rate hearings, ensure consideration of them.

5.83 In respect of securities issued by a gas utility, Mr. Paddon said that the Board should not have a pre-issue role because the mix of securities is dealt with effectively in rate cases. Consumers' is also opposed to any interference with its dividend policy. The capital structure of the utility for regulatory purposes is directly affected by the amount of dividends paid out. Hence, the dividend conduct of the utility is constantly being reviewed.

5.84 Mr. Paddon pointed out that under the Ontario Business Corporations Act, directors cannot authorize dividends that leave the corporation insolvent. Many companies pay dividends higher than annual earnings and in Consumers' opinion it would be wrong to restrict the level of dividends to the amount of earnings. Dividend policy is a matter for management and if left to the OEB it would create uncertainty in the minds of investors and increase the cost of capital.

5.85 Mr. Paddon said that transactions with affiliated companies should be allowed if in keeping with corporation securities law. They should be reviewed in rate cases but not prevented initially. Consumers' should be entitled to purchase gas from its own affiliate. It would be unrealistic for there to be a rule requiring pre-approval of the Board in respect to an affiliated transaction in the commodity in which the utility deals.

5.86 Diversification by the utility should be allowed without reservation, in Consumers' opinion. In rate proceedings diversification can be examined to determine the degree of cross-subsidization, so that the integrity of the company's main business, that of gas distribution, can be protected. Consumers' stated that management has the responsibility to maximize the efficient and effective utilization of all the company's assets and the OEB should be sympathetic to this. Moreover, there should be no distinction between utility-related or unrelated diversification.

5.87 Mr. Roland on behalf of Inter-City said that in Inter-City's view undertakings were unnecessary for the protection of the public interest. A prudent owner's behaviour would in any event be consistent with undertakings because the alternative would entail unfavourable treatment from the Board and consequential impairment of its investment. Mr. Roland referred to the Board's very broad powers to regulate generally under Section 19, including rewarding and penalizing management decisions; the broad monitoring power through rate cases and the Energy Returns Officer and the Board's ability to make rules regulating its procedure, including monitoring of utilities and their performance of undertakings, under Section 27 with the approval of the Lieutenant Governor. In this connection Mr. Roland suggested it would be preferable for the Board to be able to make its own rules without having to go to the Lieutenant Governor.

5.88 With respect to the enforcibility of undertakings, Mr. Roland argued in favour of better monitoring of them. If there is concern about their enforcibility, legislation with specific provisions for remedies should make them binding. He said that the utility and the immediate owner should be parties to the undertakings.

5.89 Inter-City is opposed to the additional level of regulation created by affiliated interest rules. Mr. Roland argued these are more effectively dealt with under ongoing regulation.

5.90 Mr. Roland agreed with Mr. Howard with respect to the issuance by the utility of securities, the payout of dividends, the incurring of indebtedness, loans and investment in non-utility areas, and diversification within the utility, namely that these matters are best left with the management of the utility, while Mr. Roland felt that dividend payout is a matter for management discretion, it should be open to review by the Board at a rate hearing.

5.91 Mr. Kawalec said that rules and regulations should restrict utilities to gas distribution except where the Board's prior approval is given to associated businesses e.g. furnace manufacturing.

Other Issues Raised by the Takeover

5.92 Mr. Campion proposed that Union Gas be required to maintain its Head Office in Chatham.

5.93 In Board Counsel's view, joint costs, reorganization costs and acquisition premiums are matters which should be dealt with in ongoing regulation before the Board.

5.94 Board Counsel submitted that the Ontario utilities should be encouraged to:

i) retain or commence a substantial common share float so as to obtain full access to the financial markets;

ii) retain as much activity as is reasonably possible in the franchise area; and

iii) maintain a pure "stand alone" utility. Mr. Campion did not see these items as part of any legislation, but rather as policies enunciated by the Board.

5.95 Unicorp believes that the location of the Head Office of a utility cannot be the subject of a general rule. Unicorp believes that the Head Office should be located in the franchise area where it can best serve its customers efficiently. With respect to Union Gas, Unicorp affirmed that there is no intention or reason to change the Head Office's present location from Chatham.

5.96 At most, Unicorp suggested that a change in location of a utility's Head Office should be subject to the OEB's consent.

5.97 Mr. Leibel said that Unicorp is opposed to a mandatory common share float, pointing to the fact that neither the acquisition of Northern & Central by Inter-City nor the reorganization of Union Gas, were subject to the requirement of a float. Furthermore, there is no way of ensuring that the float would be widely held and no evidence that it would assist regulation.

5.98 Mr. Howard, for Union Enterprises/Union Gas had doubts that the Board could direct the location of the utility's Head Office; he saw this as best achieved by an offered undertaking. He agreed that joint costs should be left to ongoing regulation as suggested by Board Counsel. He supported Mr. Leibel in his opposition to a common share float. He felt it unnecessary to encourage a utility to retain as much activity as possible in the franchise area.

5.99 Mr. Thompson, on behalf of IGUA, said that the utility's Head Office should be in the franchise area and located where it can best serve its customers efficiently. IGUA believes that a common share float should not be a requirement.

5.100 Mr. Ryder, for the City of Kitchener, said that matters of the Head Office location and the composition of the utility's Board of Directors should be enforcible as Orders of the Board. He also proposed that the OEB Act be amended to include a provision that imposes on the gas utilities the duty to conduct their affairs with a view to providing efficient and reliable service at reasonable costs. This, he suggested, would enable the Board to deal with items not specifically prohibited and which cannot be dealt with directly under the Board's rate-making powers. Mr. Ryder also proposed that the Board be given powers to make orders considered necessary to enforce the duty of the utilities. Examples given were for orders setting aside transactions by the utility; divestiture as a remedy of last resort; and the establishment of a common share float.

5.101 Mr. Paddon, for Consumers', said that the chief operating office should be located at the core of the utility's business. While it was unimportant where the Head Office was placed, he felt that a location near the financial market centre was probably best.

5.102 Consumers' is in favour of a common share float since this would provide a significant benefit in the flexibility of future financing. To attract a float, the non-utility diversified activities should be carried on either by the utility or by a subsidiary of the utility.

5.103 Mr. Roland stated that Inter-City was not in favour of establishing a common share float. A 10 percent level (the present Consumers' level) would not be large enough to attract institutional investors to Northern & Central. Mr. Roland objected to Mr. Campion's recommendation that such a float should be encouraged by the Board.

6. THE PUBLIC INTEREST

6.1 The Order in Council requiring the Ontario Energy Board to hold a hearing and to report regarding the acquisition of (more than twenty percent of the common shares of) Union Enterprises by Unicorp, raises the question of whether the public interest regarding price, service and reliability will be jeopardized by the change in control of Union Gas.

6.2 The question of the public interest in the Unicorp/Union Enterprises transaction was seen by the Board as pertaining

- first, to the specific effect on present and future shareholders and investors in Union Enterprises and Union Gas, and on Union Gas's customers and others utilizing Union Gas's transmission and storage facilities (Phase I of the hearing), and
- second, to the general implications for the other two major natural gas utilities

in Ontario and to relevant holding companies (Phase II).

6.3 The Board defined these aspects of the public interest in the its Procedural Order of February 18, 1985 as follows:

> 10. To the extent that the matters raised in Phase I of the public hearing touch upon a consideration of the public interest, it may be defined in part to be the benefits and detriments to:
>
> a) present and potential shareholders of Enterprises and Union Gas;
>
> b) the customers, Ontario communities and industries served by Union Gas;
>
> c) investors in Enterprises and Union Gas other than the shareholders;
>
> d) other persons in the Province of Ontario who would benefit from secure natural gas transmission, storage and distribution at a reasonable cost; and
>
> e) the public interest generally.
>
> 11. To the extent that the matters raised in Phase II of the public hearing touch upon a consideration of the public interest, it may be defined in part to be as set out in paragraph 10 hereof

> but changed to apply to all gas utilities operating in Ontario and all relevant holding companies.

6.4 Unicorp appealed the Board's Proce- dural Order to the Divisional Court of the Supreme Court of Ontario on the grounds that the Board's definition of the public interest in its Procedural Order was too broad. The Court dismissed the appeal. In his Endorsement on the record dated March 14, 1985, Mr. Justice Henry said:

> A portion of the preamble to the order in Council which refers the question to the Ontario Energy Board reads as follows:
>
> "Whereas a number of major customers of UGL [Union Gas Limited] and a number of municipalities from which UGL holds service franchises, have expressed considerable concern and are seeking assurances that their interests and the public interest in public service and reliability will not be jeopardized by the proposed transaction;"
>
> Our interpretation of that recital is that it expresses the concern of the Lieutenant Governor in Council in relation to the general public interest that price, service and reliability will not be jeopardized by the proposed transaction. We regard that principle as fundamental to the whole enquiry.

> The question referred to the Ontario Energy Board must be read in that light. We do not see how the Board could determine those factors, particularly reliability, without enquiring into the financial and otherfactors underlying the proposed transaction.
>
> For these reasons we see nothing inappropriate in the enquiries that the Board seeks to make. It is our opinion that the enquiry conducted in the manner proposed by the Board is in conformity with both the Order in Council and s.36 of the Act. The application and the appeal if any are therefore dismissed.

6.5 As a consequence of this decision the Board adhered to its original understanding of the public interest.

Earlier Considerations of the Public Interest

6.6 The first occasion on which this Board considered the question of the public interest directly and in general terms was in 1969 when Consumers' Gas applied (unsuccessfully) to the Board for leave of the Lieutenant Governor to acquire a controlling interest in Union Gas. In its report to the Lieutenant Governor of July 6, 1970, (under EBO 36) the Board said in respect of the public interest:

> One of the problems in assessing the public interest is that a benefit to one group is often a detriment to another. Thus some cost reductions, which benefit the operating company and, under rate regulation, ultimately benefit the customers or share holders or both, might be at the expense of another sector of the public, for example, the employees. Cost reductions brought about by a reduction of the level of service might benefit shareholders at the expense of customers. Changes in income tax accounting to bring about benefits to present customers or shareholders might be at the expense of future customers or shareholders, or both.
>
> Under these circumstances it is obvious that the assessment of the public interest is not simply a matter of whether there is a specific benefit or a specific detriment. Rather, the Board, in arriving at its opinion, must weigh the various benefits against the various disadvantages and come to a conclusion as to whether there is an overall benefit or detriment to the public interest or conceivably whether, having regard to the advantages and disadvantages, there is no overall effect on the public interest.

6.7 More recently, in the fall of 1984, the Board again considered the question of the public interest in general terms. Inter-City Gas Corporation and associated companies had applied to the Board for leave of the

Lieutenant Governor to acquire 100 percent of the shares of Northern and Central Gas from the previous owners, Norcen Energy Resources Limited. A hearing was held and leave was granted. In its report dated January 16, 1985, the Board said, in respect of the public interest:

> Although Section 26 of the Act does not refer to the public interest or, for that matter, to any other considerations the Board is to use in arriving at its opinion of this transaction, the Board considers that the public interest is of paramount consideration. The question then arises, "what is the public interest?"
>
> In searching the case law on the point, the Board has found literally hundreds of cases in Canada and the United States in which courts or administrative boards have employed the test of public interest in a variety of factual situations. The location of highways, pipelines and transmission towers, the granting of radio licences, natural gas franchises and trucking permits have all been based on the test of the public interest in one sense or another. The wide variety of cases in which it has played some part in a decision, effectively means that the findings of those tribunals do not lend themselves to a clear codification. In fact, just defining what "public" the interest refers to, is difficult in itself. A "public" opposed to the building of a nuclear reactor seldom

represents all the "publics" affected -- it does not speak for the construction unions or the mine workers, it does not speak for the investors in the station or even all the consumers, but the "public" presenting its iews still purports to represent the "public".

Of the public interest, Mr. Justice Holmes said: "We mean, of course, considerations of what is expedient for the community concerned." Many other legal theorists have left behind similar quotations, but because of the diverse applications to which the words "public interest" have been applied, there is not a single, simple explanation of sufficient clarity to be particularly helpful.

In its Procedural Order the Board outlined the public interest for the purposes of this hearing to be the benefits and detriments to:

1. present and potential shareholders, investors and Ontario customers of Northern;
2. the shareholders and Ontario customers of Inter-City;
3. the Ontario communities served by Northern and Inter-City;
4. securing natural gas transmission, storage and distribution at reasonable cost to consumers in Ontario; and
5. the public interest generally.

These general parameters have been used in the past by the Board although a specific test of the public interest has never been delineated.

In the opinion of the Board, the public interest can only be more particularly defined by examining the facts and nature of the situation in which the test is to be used. The public interest will consistently take the form of the facts to which it is applied, moulding itself to the specific use to which it is being put.

Having determined that the public interest is not generally definable, the Board would add that, in spite of its elusiveness, when it is applied to a specific set of facts, the reasonable man of the Common Law has no trouble determining if a particular act meets the test. A transmission tower, by this test, might be located in a productive, peaceful countryside, in spite of the residents' objections if the tower is found to be in the public interest of a nearby population centre. The public interest of the urban residents may be said to outweigh the local interests of the rural public in those circumstances.

Lord Coke put it succinctly when he wrote:

> "The law prefers the public good to the private good and that if it has to choose between prejudice to the many and mischief particular to individuals, the individuals must suffer."

The broader social concept of public interest has lurked beneath the Common Law even in its earliest formative period and the Board's duty

> now is to apply it to the facts of this case.
>
> In the regulatory context of the transaction presently before the Board, the public interest is not served if Northern, following the sale, is unable to serve the public, except at unreasonable prices. Alternatively, it follows that the public interest is served if those who want the utility's services obtain those services at rates which are not adversely impacted by the transaction. While a checklist of value conflicts is impracticable, it is possible to derive specific questions related to the facts of this case, the answers to which are essential to the Board in its consideration of the public interest:
>
> 1. Can Northern continue to meet its obligations to serve present and future customers without unreasonable conditions of service and rates caused by the sale of its shares?
> 2. Can Northern maintain itself in a sound financial condition so that the public can continue to be served, in the short and long term, in a manner which will contribute to the public's general well-being?

6.8 In broad terms, the public interest will be satisfied by an undertaking or action that will result over time in an enhancement of the economic or general welfare of the public. The public interest can be satisfied without improving the economic or general welfare of every member of society; indeed, it is possible that the public interest in general can be satisfied even if some members of society are economically damaged. Essentially, one might interpret the public interest as the best possible accommodation of conflicting interests.

6.9 In the regulatory context, the OEB follows a judgemental path in resolving conflicts of particular interests so as to arrive at a decision which the Board feels to be the best possible, in the public interest. There are no firm criteria for determining the public interest that will hold good in every situation and, generally speaking, it is probably preferable not to attempt to define these criteria too closely. The public interest is dynamic, varying from one situation to another and the criteria by which the public interest is judged may also change according to the circumstances. In considering the criteria, the Board must exercise judgment as to the specific values of conflicting interests. It must decide whether the public interest would be done any disservice in the event that the particular proposal was not approved.

The Unicorp/Union Transaction

6.10 In considering the implications of the Unicorp/ Union Enterprises transaction at this hearing, the Board has again sought to identify the public interest, while keeping several factors in mind. These are

- the social contract between the gas utilities and the Government;
- the on-going regulation of Ontario gas utilities by this Board;
- the joint undertakings given by Unicorp and Union Enterprises, and the undertakings previously given by Inter-City/ Northern & Central and by Hiram Walker/ Consumers'; and
- the free choice of individuals, corporations and institutions to invest and to transfer that investment in Ontario gas utilities or holding companies of gas utilities.

6.11 The issues of undertakings and of freedom of investment are discussed in later chapters; discussion of the social contract and of on-going regulation are presented as follows.

The Social Contract

6.12 In return for a gas utility providing reliable service to customers at reasonable rates within the franchise area, the enfranchising municipality and the Government of Ontario under the Public Utilities Act and the Municipal Franchises Act, effectively guarantee a secure market to the utility, free of competition from other gas distributors. This obligation on the part of the utility is a legal obligation but it is also a social trust that flows from the franchise contract.

6.13 The utility's business is to serve the public in the enfranchised area and its continuation in business is dependent upon its performance in the communities that it serves. Change of ownership or control of a utility brings with it the obligation on the part of the new owners, or those in control, to continue to maintain that performance. Ownership or control of a utility may change but the utility must continue to maintain acceptable standards of service.

6.14 The Board has heard no evidence that the ownership per se of a controlling proportion of the common shares of a major Ontario gas utility by a holding company has had any untoward effect on the performance of a utility in regard to its legal obligations or its social contract to its customers and to other members of the community.

Regulation by the Board

6.15 The provision of continuing gas service to the public at just and reasonable rates is an ongoing responsibility of this Board. The procedures and precedents by which rates are approved have been well established through the Board's regular rate hearings of the respective utilities, regardless of the ownership or control of the utilities' shares. For example, when Hiram Walker Resources was established as a holding company controlling Consumers' Gas, this had no effect in principle on subsequent hearing procedures with respect to Consumers' rates to its customers. Similarly, the change of ownership of Northern and Central from Norcen to Inter-City will not effect in principle the regulatory treatment of the utility.

6.16 At the hearing, the Board heard no evidence that suggested that the change in ownership of Union Enterprises and hence of Union Gas, (regardless of the degree of concentration of that ownership), would affect in principle, Union Gas's subsequent regulation before this Board.

6.17 However, this indirect change of control of Union Gas, together with the previous changes of control of Northern and Central and Consumers' Gas, requires a reconsideration of the Board's overall power if it is to act effectively in the public interest.

7. HOLDING COMPANIES, TAKEOVERS AND CONCENTRATION OF CONTROL

7.1 In the case before the Board, one holding company, Unicorp, took over another holding company, Union Enterprises, which controlled a gas utility, Union Gas, regulated by the Board. In this chapter the Board first gives a review of holding companies and takeovers generally as they have related to Ontario natural gas utilities, and then discusses the question of concentration of control of market and of company ownership. The chapter concludes with the Board's findings regarding Mr. George Mann's control of Unicorp and the financial stability of Unicorp and with its recommendation respecting the takeover of Union Enterprise by Unicorp.

HOLDING COMPANIES

7.2 Holding companies are a common phenomenon in industry and commerce. A holding company is defined by the Canadian Institute of Chartered Accounts as "a corporation whose principal business is owning a controlling interest in the shares of one or more other corporations"

7.3 As is well known, one holding company can control another holding company, and a corporate structure can reach labyrinthine complexity. Appendix C in Volume II sets out the corporate structures of Unicorp and Union Enterprises as well as those of Inter-City, Hiram Walker, and Hees International.

7.4 Virtually all of Canada's major utilities are now owned or controlled by holding companies.

- Electrical Utilities. Of the five major electrical utilities in Canada, other than government-owned electrical utilities, two are owned or controlled by holding companies, two are smaller Eastern utilities, and one appears to be widely held.
- Telephone Utilities. There are seven major non-government-owned telephone utilities, all of which are controlled by holding companies.

- Oil Pipelines. Both major oil pipeline companies are controlled by holding companies.
- Gas Utilities. All eight major gas utilities, including the three in Ontario, are controlled by holding companies.

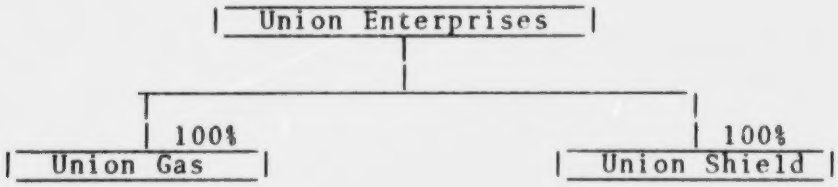
7.5 All three of Ontario's major natural gas utilities have undergone changes of corporate structure which have resulted in their being controlled by holding companies, and all of these changes have been approved either following a recommendation directly by the Board or by the Lieutenant Governor.

- In 1975 Northern and Central Gas and Norcen Energy Resources Limited ("Norcen") reorganized to establish Norcen as a holding company with Northern and Central as a subsidiary.
- In 1980 Consumers' Gas and Hiram Walker reorganized ultimately creating Hiram Walker Resources as a holding company and Consumers' as a subsidiary.
- In 1984 Norcen sold its interest in Northern and Central to Inter-City Gas and associated companies.

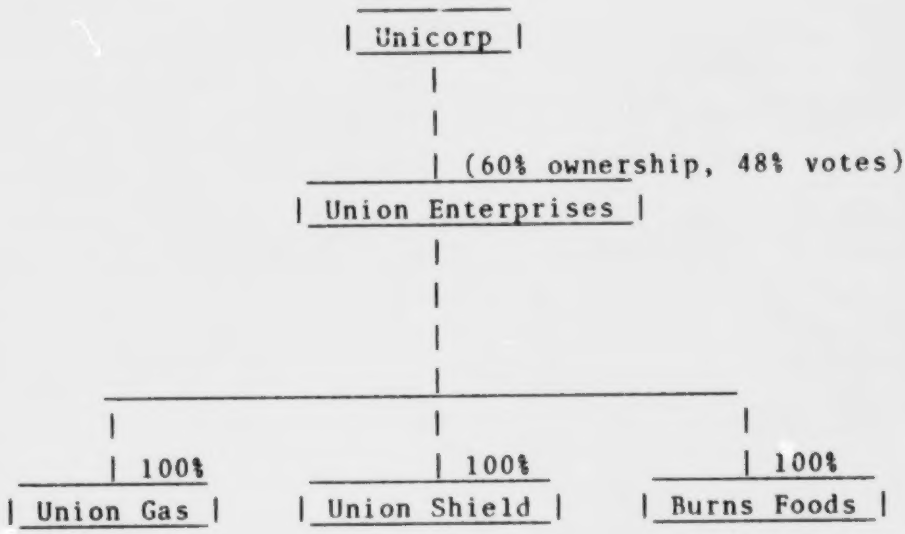
- On January 1, 1985 Union Gas reorganized itself into a holding company, Union Enterprises, and two subsidiaries.

7.6 In the case now under consideration by the Board, Unicorp has succeeded in gaining control of Union Enterprises, which in turn controls Union Gas. In looking at this takeover, one must remember that Union Gas was already owned and controlled by a holding company with the concurrence of the Lieutenant Governor. What is important about this transaction is that there has been been an indirect real change of control of a gas utility in Ontario through the change in control of a holding company which controls a gas utility. It is the indirect nature of the change of control of the utility that challenges the role of the Board and the intentions of existing government policy.

7.7 Before the takeover, Union Enterprises was a holding company owning 100 percent of two subsidiaries. Union Enterprises thus had a direct control of Union Gas.



7.8 Once the Unicorp transaction was completed the holding company structure changed as follows:


Unicorp
(60% ownership, 48% votes)
Union Enterprises
100%
100%
100%
Union Gas
Union Shield
Burns Foods

7.9 Unicorp now controls Union Enterprises directly and thereby controls Union Gas indirectly. Any number of holding companies could be placed on top of Unicorp thus putting Union Gas further down the ladder and making the control of Union Gas by the top holding company even more indirect.

7.10 At the hearing, there was no evidence before the Board which established that holding companies are per se, contrary to the public interest, as they relate to natural gas utilities.

The Lieutenant Governor has accepted the passing of control of all three natural gas utilities to holding companies. In the case of the Unicorp/Union Enterprises - Union Gas transaction, it is the transference of the control of one holding company which owns a utility to another holding company which is in question. Is the new holding company appropriate and in the public interest? What power of approval does the government wish to maintain over such transfers of control?

Takeovers

7.11 A takeover is an event or an act by which one company acquires control of another company. A takeover may be friendly - i.e., supported by the existing management or controlling interest of the company, or it may be hostile, i.e., opposed by the existing management or controlling interest.

7.12 When a takeover is hostile (resisted by existing management), as was the case with Unicorp's successful attempt to take over Union Enterprises, it can become an event attracting much public attention.

7.13 There were five documents filed in this hearing which attempted to analyze the takeovers of TSE-listed companies since 1978.

7.14 A company becomes attractive for a takeover when a gap develops between the perceived underlying asset value and the market value of stocks. Consequently, a takeover usually involves a substantial premium over the market value.

7.15 Although all takeovers do not follow the same pattern, some features of takeovers, such as the costs of reorganization, the costs of acquisition and the acquisition premiums, give the Board concern when it comes to Ontario gas utilities. These are discussed in chapter 9.

7.16 Many economists and investment or portfolio managers support the concept of takeovers. This enthusiasm, however, seems to presume in the case of a public utility, that certain safeguards are in place, such as the existence of this Board and appropriate regulatory powers, or that there are enforcible undertakings in place between the "taker" and the "takee".

7.17 Advantages that are said to accrue to the economy as a result of takeovers include the following:

i) a more efficient allocation of resources;

ii) more efficient management; even the possibility of a takeover keeps management striving for excellence;

iii) a higher return to shareholders on their investment; and,

iv) economies of scale and scope.

7.18 Against these advantages there are said to be disadvantages:

i) The fear of takeovers may change corporate strategy from long-term substantial plans to short-term interim gains as management attempts to obtain faster immediate returns on investment, which may not be prudent in the long run.

ii) A takeover may place a heavy debt on the shoulders of the company taken over or on the takeover company, because the takeover is often financed by issuing debt with an attractively high return (sometimes generically called "junk bonds"). In the case of a public utility in Ontario, such a debt on the shoulders of the takeover company could be a serious disadvantage if the financial strength of the company is weakened and made more risky as a result. The debt-carrying ability of the parent or grandparent of the utility may affect the cost of capital to the utility and may thus ultimately affect the level of rates charged to the customers of the utility.

iii) Takeovers can lead to restructuring the new corporate organization and in many cases this has lead (at least in the USA) to the selling off of some of the subsidiary companies in the family. In the Board's view it would be possible to structure a transaction whereby Unicorp could sell Union Gas without being constrained by Section 26(2) of the Act. So long as Union Gas is owned by a holding company, the control of the holding company can pass around without breaching section 26 (2). In the Board's view, the indirect sale of Union Gas, in the course of corporate restructuring may not be in the public interest, unless it is accompanied by adequate restrictions.

iv) Takeovers can lead to consolidation of operations and ventures. In the case of a gas utility this may not be in the best interests of the customers. Consolidation may create accompanying, incompatible, non-regulated activities for the utility to carry on which could detract from the desirable application of the stand-alone principle, or make regulation of the utility difficult.

v) Takeovers can unsettle both management and staff. This was attested to by Mr. McKeough and Mr. Edgell. If a prolonged dispute takes place the effect could be serious. Takeovers have the potential to unsettle the investment market and thereby increase the cost of capital in the long run.

vi) Takeovers can lead to increased leverage. When a mature gas utility with a secure revenue is part of a takeover there could be a tendency to maximize the utility's capital-raising possibilities. In the Board's opinion, it is undesirable that Ontario gas utilities be over-leveraged: this would increase the risk of a utility and hence its cost of capital which would translate into increased rates to customers.

vii) Takeovers can lead to a heavy debt as the Board has commented above and this in turn can lead to dividend and asset stripping in order to repay the debt and thus weaken the financial strength of the parent or the utility and so affect customer rates.

7.19 Conclusion: In the Board's opinion the balance between the advantages and disadvantages of takeovers tilts potentially towards the disadvantages in the case of a gas utility in Ontario. This is the main reason why the Board recommends constraints upon the direct or indirect change of control of a gas utility in Ontario.

Concentration of Control

7.20 Concentration of control can refer either to the control of a company by an individual or entity, or the control of a market by a single company.

7.21 In reviewing monopolies and anti-competitive practices, one has to bear in mind that in terms of gas distribution, the very nature of the industry is one of government-authorized and regulated monopoly. In the case of Ontario's natural gas utilities, the franchises create monopolies, but the monopolies thus created are not unrestrained.

i) The franchises set out firm, enforcible duties.

ii) Much of the operation, the level of service, the price of the service and the way in which the monopoly is managed, has long been subject to the close scrutiny of this Board.

iii) None of the gas monopolies are truly without competition, for they face competition from one another in the sense that for example, an industry may locate in one franchise area as opposed to another depending on the cost of gas. Gas monopolies also face competition from other energy sources such as oil and electricity.

iv) The operation of the monopolies are watched closely by investors, customers, and analysts alike. The customers have an assortment of remedies which they can seek before this Board.

v) The presence of Board regulation represents a form of moral suasion.

7.22 The evidence presented was strongly in favour of gas distribution monopolies being granted by the Legislature in Ontario, subject to regulation by this Board. Any differences in the evidence rested upon the breadth and depth of the regulation, rather than on the need for it.

7.23 In the Board's view there are important advantages in having the three major Ontario gas distributors separately controlled and operated. The gas companies offer each other a degree of competition, and the Board, by having a basis of comparison, is greatly assisted in its regulation.

7.24 Keeping the three gas distributors separate from one another was clearly the government's concern when it introduced legislation in 1969 which restricted one gas utility company from taking over another which would have created a monopoly of monopolies. (See chapter 10 for a history of that legislation.)

7.25 In considering the question of concentration of control of a company or a group of companies by a single individual or entity, the Board is of the general view that economic efficiency (obtaining the most effective allocation of resources, thus providing goods and services at the lowest competitive cost) should not be interfered with unless anti-competitive constraints are necessary.

7.26 Traditionally, apart from questions of foreign control, or control by criminal elements, we in Canada have not attempted to constrain the acquisition of control of a corporation, unless such control leads to control of a market. (If a market is controlled this can lead to monopolistic abuses.)

7.27 In the Board's view, the evidence in this hearing supports the conclusion that unless there are certain and clear advantages in interfering with the organization and reorganization of capital in Canada, then except for serious constraints on competition or a resulting criminal activity, constraints cannot be recommended at this time.

George S. Mann and Unicorp Canada Corporation

7.28 An initial reaction to the takeover of Union Enterprises by Unicorp was the concern that one person (Mr. George Mann) would control Union Gas. In fact the Board of Union Enterprises issued a statement to its shareholders which stated:

> The [Union Enterprises] Board believes that no one individual should control a public utility such as Union Gas. Union Gas is Ontario's

> second largest distributor of natural gas, serving approximately 500,000 industrial, commercial and residential customers in southwestern Ontario. The [Union Enterprises] Board believes that it is not in the public interest nor in the interest of these customers that the quality and integrity of their natural gas service should be dependent upon a single person.
>
> Unicorp is dominated by a single shareholder, who by means of a relatively small investment and a capital structure built on non-voting shares, tightly controls Unicorp.

7.29 On February 15, 1985 the Minister of Energy in a press release included the following statement:

> Of concern to some, as well, is the concentration of effective control of a major utility company in a single pair of hands.

7.30 Some witnesses felt that positive benefits could flow from a sole owner with a significant financial stake and a dedicated attention to its efficient and successful operation.

7.31 The matter of ownership by one person was put into perspective by the witness Dr. Waters, when he stated that Section 26 was designed so that its initiators could

> ...observe the identity and characteristics of new significant owners

> of a utility before they became owners. If you are satisfied that the relationships between an owner, whoever he might be, and the utility cannot compromise the public interest, then it seems to me you do not need to concern yourself about the ownership aspect. You simply have to set up some rules of behaviour for an owner - regardless of whether he has a minority interest or a majority interest - or for the Board of Directors who are acting for no particular controlling shareholder. I think you want to be sure that the rules that are there, permit you to have the comfort that the utility will always be able to, under all reasonably foreseeable events, provide services.

7.32 Mr. Liebel put the matter succinctly in his argument when, having stated the potential for a financially strong parent today to become financially weak tomorrow, he said that

> the protective machinery around the utility must be constantly and continuously in operation. We believe that any determination of the financial stability of Unicorp (or Union Enterprises, for that matter) in May of 1985 may be comforting, but it is of no long-range value unless there are proper undertakings or affiliated interest rules in place to protect the utility regardless of the good or bad fortunes of the parent in the future.

7.33 At the hearing, Mr. Mann was closely examined as to his plans for Union Enterprises and Union

Gas. He denied any suggestion that his investment in Union Enterprises is short-term and specifically confirmed that he has no intention of selling Union Gas. Although Mr. Mann indicated that there might be some scope for combining Union Shield with other oil and gas interests of Unicorp, he emphasized the stable and ongoing role of the utility in the Unicorp/ Union Enterprises organization.

7.34 Mr. Mann testified that the utility would continue to be run by Union Gas's staff: "Nobody will be adversely affected...if anything we will be able to come up with ideas that can improve the service and cost of product to the customers of Southwestern Ontario". Mr. Mann referred to the improved performance of trust companies (Royal, for example) following their takeovers by controlling/sole shareholders. He saw no disadvantage and perhaps advantage, to the possibility that a public utility could be controlled by one shareholder.

7.35 There were conflicting views expressed regarding Unicorp's financial strength, particularly as to the additional strain that might be placed on Unicorp in certain circumstances and its possible spillover effect on Union Gas, which might create a higher cost of capital for the utility. Having heard the evidence, the Board is satisfied that although Unicorp is extended by the purchase of Union Enterprises, Union Gas will not be jeopardized, nor does the Board anticipate that the cost of capital will increase to Union Gas as a result of the takeover, provided the joint undertakings as revised by the recommendations of the Board (see chapter 9) are in effect.

7.36 Conclusion: The Board concludes that the concentration of control of Union Enterprises in the hands of George Mann is not in itself disadvantageous and is not different from the dozens of other corporate concentrations in Canada.

Recommendation

7.37 The Board recommends to the Lieutenant Governor that, subject to the other recommendations set forth in this Report, no action be taken to interfere with the takeover of Union Enterprises by Unicorp Canada Corporation.

8. SPECIFIC FINDINGS

8.1 This chapter presents the Board's findings on several matters specifically related to issues raised by the Unicorp takeover of Union Enterprises and hence of Union Gas. These are:

1) The presentation and disclosure of financial forecasts
2) Acquisition Premiums and the Takeover
3) The Union Enterprises/Union Shield Preference Share Interlock
4) The Precambrian Guarantee by Union Gas
5) Fairness to Union Enterprises Shareholders.

The Presentation and Disclosure of Financial Forecasts

8.2 The Canadian Institute of Chartered Accountants in its Handbook provides guidance on the presentation and disclosure of a financial forecast in documents such as a prospectus or a takeover bid and is intended primarily for companies presenting financial forecasts in documents filed with the O.S.C. or other securities commissions in Canada. Unicorp, Union Enterprises and Union Gas are examples of companies which present such information to the O.S.C. This guideline should apply equally, in our opinion, to the filing of forecasts before this Board in the present and future proceedings.

8.3 The C.I.C.A. defines a financial forecast as an estimate of any or all of:

a) the most probable results of operations;
b) the most probable financial position; and
c) the most probable changes in financial position,

for one or more future periods not completed when the estimate is made. "Most probable" in the context of this guideline, means that the forecast is based on management's judgement of both the most likely set of conditions and the enterprise's most likely course of action.

8.4 It is important to distinguish between a financial forecast and a financial projection. A projection is an estimate of financial results of an enterprise based on assumptions which are not necessarily the most likely or most probable. In contrast to a forecast, a projection is not necessarily indicative of the most probable results but merely reflects the effects of specified assumptions.

8.5 Unicorp, in our view, provided projections rather than forecasts in this case and consequently the information provided was not as helpful as it could have been.

8.6 In its initial March 29, 1985 answer to question 2, Financial Data, Schedule A to Procedural Order #3 requesting 1985 and 1986 financial information Unicorp replied as follows:

> Unicorp has been advised by its counsel and the Ontario Securities Commission that it cannot publicly issue forecasts as long as its offer for Enterprises is outstanding unless the O.S.C grants appropriate exemptions. Unicorp intends to apply for such exemption. Unicorp is prepared to file forecasts with the OEB on a confidential basis...

8.7 In Unicorp's amended answer filed April 9, 1985, the following caveat was appended:

> These pro forma statements have been provided for the specific purpose of responding to E.B.R.L.G. 28, Procedural Order - 3 and are not to be interpreted as financial forecasts. The pro forma

> statements are not necessarily indicative of the most probable results but merely reflect the effects of certain specified assumptions. Certain of these assumptions, along with other data, have been provided to Unicorp by third parties for the purposes of compiling the pro forma statements. Unicorp is unable to, and accordingly makes no representation as to the completeness and/or accuracy of those assumptions.

8.8 In this case the Board recognized the problems raised by Unicorp and was satisfied that the data provided by these projections were adequate for purposes of this Report. It further recognizes the difficulty for a company, predominantly in the real estate business, to provide meaningful forecasts. For these reasons the Board chose not to make an issue of the matter in this particular case. This should not be construed, however, as precedent for conduct of the parties in future cases before this Board.

8.9 Since it would appear that there is doubt as to the Board's authority to require financial forecasts when necessary, the Board recommends that the Ontario Energy Board Act be amended to enable the Board to order that the necessary evidence be produced.

8.10 The Board notes further that, under the heading of "Acquisition of a Business" the C.I.C.A. Handbook provides the following guidelines:

> When the proceeds of an issue of securities offered under a prospectus are to be used to finance the acquisition of a business and in other takeover situations, management may decide to present forecast data for its own enterprise and for the business that has been acquired or is proposed to be acquired. It is preferable that this data be presented in the form of a pro forma forecast on a consolidated basis. The pro forma forecast should be prepared on the basis of the accounting policies expected to be used in the future for the combined operations.

8.11 While the C.I.C.A. provides additional detailed guidelines with respect to accounting presentation and disclosure, it will suffice here to note that disclosure should also be made of any interpretation of the forecast, such as trust deed restrictions, pending law suits and dividend restrictions.

8.12 Further, the C.I.C.A. publishes guidelines for auditor review of financial forecasts, which are very specific. However, as the Board has not required that "forecasts" filed in this proceeding be subjected to audit review, no further comment is necessary in this case. It should be noted, however, that in future OEB cases where forecasts are of paramount importance, they may be ordered by the Board, to be subjected to audit review.

Acquisition Premiums and the Takeover

8.13 In understanding the implications of takeovers it is important for the Board to analyse the significant "acquisition premiums" which arose out of the purchase of Union Enterprises by Unicorp and the purchase of Burns Foods by Union Enterprises. Before commenting on the magnitude and significance of those premiums, acquisition premiums incurred by Canadian businesses over a recent five year period are examined.

8.14 During the proceedings, Board Counsel filed as Exhibit No. 54 a series of articles published by Richardson Greenshields of Canada Limited entitled "Takeover Fever". The first article was published on January 19, 1979 and the last article is dated March 10, 1983. The series covers the five year period January 1, 1978 to December 31, 1982 inclusive. In summary the following tables show the ranges, medians and adjusted averages of offering prices to market prices (Table 1) and to book values (Table 2) on a year by year basis throughout the five years surveyed.

Table 1

OFFERING PRICE PREMIUM TO MARKET PRICE

	1982	1981	1980	1979	1978
Range	11%-71%	(14%)-71%	4%-73%	4%-104%	7%-75%
Median	32%	17.1%	30%	20%	36%
Adjusted Average[1]	30%	23.1%	34%	22%	26%

1. Average adjusted to exclude extreme points on range.

Table 2

OFFERING PRICE PREMIUM (DISCOUNT) TO BOOK VALUE

	1982	1981	1980	1979	1978
Range	(5%)-320%	(19)-620%	(71%)-473%	22%-585%	(58%)-580%
Median	40%	68%	93%	125%	39%
Adjusted Average[1]	84%	117%	111%	131%	58%

1. Average adjusted to exclude extreme points on range.

Source: Exhibit 54.6, page 3.

8.15 The above information demonstrates that:

- i) acquisition premiums when compared to market prices fluctuated widely from minus 14 percent to plus 104 percent;
- ii) acquisition premiums when compared to book values fluctuated by extremely large percentages ranging from minus 58 percent to plus 620 percent;
- iii) acquisition premiums when averaged on a reasonable basis fell within a range of 22 percent to 34 percent for Table 1 Market Prices; and
- iv) acquisition premiums when averaged on a reasonable basis fell within a range of 58 percent to 131 percent for Table 2 Book Values.

8.16 The acquisition of Union Enterprises by Unicorp has been accounted for by the "purchase method of accounting" which is a method used for a business combination under which the net assets acquired are carried in the acquiring corporation's financial statements at their cost to the acquiring corporation. Unicorp's acquisition cost of $260,972,000 represents an excess of $46,987,000 over the estimated $213,985,000 book value of Union Enterprises net assets as at the date of acquisition.

8.17 Unicorp's acquisition premium, therefore, represents approximately 22 percent of the book value of Union Enterprises net assets. Although the amount of the premium is significant, it is on the lower end of the scale when compared with the results of the survey referred to above. The Board notes, of course, that the survey results are disclosed only as a matter of information and no other conclusions have been drawn regarding the significance of the 22 percent Unicorp premium incurred on the acquisition of Union Enterprises.

8.18 The acquisition of Burns Foods by Union Enterprises has also been accounted for by the "purchase method of accounting" as described above. In accordance with generally accepted accounting principles, the acquisition premium will be assigned to the assets and liabilities acquired, based on their fair value at the date of acquisition. Any amount remaining will be allocated to goodwill and written off over a period of thirty years.

8.19 The acquisition price of the shares acquired was $125,000,000 and the net book value of the Burns Foods' assets was approximately $62,829,000. Union Enterprises' acquisition premium, therefore, was approximately $62,171,000 which represents approximately 99 percent of the net book value of Burns Foods. The legal and other costs, presumably, including the Burns Fry opinion, associated with this transaction, which according to Union Enterprises are expected to be minimal, will be added to the acquisition premium, when known. Subject to a detailed study of the fair value of the assets and liabilities acquired, the acquisition premium of $62,171,000 (before acquisition costs) will be allocated as follows:

Land	$22,171,000
Buildings, plant and equipment	5,000,000
	$27,171,000
Goodwill	35,000,000
Total	$62,171,000

Source: Procedural Order #5, Schedule A, Question 4.

8.20 It should be noted that Mr. MacNaughton of Burns Fry Ltd. could not express any opinion as to whether the relative size of the premium could be measured in terms of other acquisitions. He did, however, suggest that the book value of the Burns Foods assets was conservatively stated, an opinion supported by the proposed accounting method as outlined above.

8.21 The Board points out that the acquisition premium of 99 percent, when compared with the unadjusted book value of the underlying assets, falls about the middle of the adjusted average percentages in the survey.

The Union Enterprises/Union Shield Preference Share Interlock

8.22 As a result of the Union Enterprises reorganization which preceded the Unicorp takeover and which became effective on January 1, 1985, Union Enterprises holds approximately $104 million of preferred shares of Union Shield. The origin of this preferred share interlock was described in Chapter 3.

8.23 At the time of the reorganization, it was anticipated that for the next few years Union Shield would be unable to meet the dividend payments on these preferred shares on its own. As a result, it was established that each year Union Gas will pay an extra dividend to Union Enterprises equal to the dividend owing to it from Union Shield. Union Enterprises will then advance this money to Union Shield which will use it to meet its dividend obligation to Union Gas.

8.24 It should be noted that as long as this arrangement is required so that Union Shield can meet its dividend obligation to Union Gas, Union Enterprises would be reluctant to allow Union Gas to go to the markets to raise equity capital on its own because the special dividend would not go solely to Union Enterprises in that case. This is a major reason why the joint undertakings should require Union Enterprises and Unicorp to provide needed equity if Union Gas cannot raise it on its own.

8.25 Mr. Cockwell, testifying on behalf of the Hees International Group of companies, was critical of the way the interlock is currently structured. He stated that it would be in the Union group's and the utility's best interest if the interlock was larger as long as as there was a very tight "ring fence" around it. This would be accomplished by borrowing the full amount of the interlock from a financial institution, but in so doing pledging only the preferred shares as security. In the case that Union Shield did not pay its dividend and as a result Union Gas did not pay the financial institution its interest, that institution's only recourse would be to attach the interlock. The utility could be further protected by a guarantee of the holding company as to Union Shield's payment of the dividend. Under these circumstances the interlock would not be an issue of concern to the Board and in fact additional amounts could be borrowed and the interlock increased.

8.26 Mr. Cockwell went on to explain that the funds raised by such borrowing would not be removed from the utility, but would be retained for use in utility activities. He acknowledged that this would result in a higher equity ratio than that deemed by the Board, but stated that this did not imply that the Board would have to reward the company on that extra equity.

8.27 The Board is of the view that the customers of Union Gas should not be exposed to the risk that Union Shield might fail to pay dividends or redeem the preference shares.

Recommendation

8.28 In order that the customers of Union Gas should not be exposed to the risk of Union Shield's failure to pay dividends or redeem its preference shares,

i) Union Enterprises and Unicorp should guarantee the payment of the preferred share dividend by Union Shield to Union Gas until the preference shares are redeemed.

ii) An undertaking should be given by Union Enterprises that, without the approval of the Board and until such time as the preference shares are redeemed, Union Enterprises will not permit any changes to the assets of Union Shield which underlie the preference shares.

8.29 Similarly, if there were any tax changes that make the preferred share dividend taxable in the hands of Union Gas, then Union Gas would not be able to dividend up to Union Enterprises the full amount of the dividend it receives from Union Shield without drawing on additional funds produced by the utility activities.

Recommendation

8.30 An undertaking should be given by Union Enterprises and Unicorp that if the dividend from Union Shield to Union Gas becomes taxable, then the preference shares would be redeemed.

Precambrian Guarantee by Union Gas

8.31 Prior to the Union Enterprises reorganization which preceded the Unicorp takeover, Union Gas had guaranteed as to interest and principal, $25 million of preferred shares issued by Precambrian to Fiberglas Canada. At the time of reorganization this guarantee was left as the responsibility of Union Gas despite the fact that Union Shield now holds the group's interest in Precambrian. This guarantee is of no benefit to the customers of Union Gas, but does place them at some risk.

Recommendation

8.32 Union Enterprises and Unicorp should guarantee to Union Gas that if it is called upon to make good on its guarantee both companies will indemnify Union Gas.

Fairness of Takeover to Union Enterprises Shareholders

8.33 During the hearing a significant amount of evidence and argument focused on whether, or to what extent, individual shareholders were disadvantaged during the course of the takeover bid. It was also argued that this matter was beyond the Board's jurisdiction.

8.34 As discussed in Chapter 6, The Public Interest, the Board included present and potential shareholders in its definition of the public interest. This is consistent with the Board's definition in its report on the Inter-City/Northern and Central Gas case quoted in chapter 6, and was upheld by the Divisional Court of the Supreme Court of Ontario following Unicorp's application for judicial review of the Board's Procedural Order.

8.35 The Board has a broad interest in the treatment of the shareholders of all utilities within its jurisdiction. This interest arises from the fact that if shareholders feel they have been unfairly treated or disadvantaged as a result of holding a utility's shares, they may be reluctant to invest in that or another utility in the future or demand a higher return for so doing. The importance of the individual shareholder to the utility and its cost of capital is highlighted by the evidence that even after the takeover, approximately 90 percent of Union Enterprises' shareholders each held less than 1,000 shares.

8.36 The Board received testimony from shareholders who appeared at the Hearing that they did, in fact, feel that they had been unfairly treated during the course of the takeover bid. Other shareholders expressed the same sentiments in letters to the Board. Mr. D. McGeachy stated emphatically during his testimony that he would not be attracted to future equity offerings of Union Enterprises.

8.37 The Board also notes the evidence that all of the major institutional shareholders of Union Enterprises sold their shares during the takeover bid and were able to do so at $12.50 cash or more. In contrast, all individual shareholders were not able to sell for $12.50 cash. Mr. Kierans stated, and Mr. Connacher confirmed, that if all individual shareholders had tried to sell their shares at $12.50 during the tender period, they would not have been able to do so; there would not have been enough demand to support that price.

8.38 It is not the Board's role to find whether or not there were any infractions of the Securities Act (Ontario) during the course of the takeover bid. It is concerned, however, that any sense of unfairness that individual shareholders have experienced be resolved and that their confidence in the company be restored.

The evidence revealed that as of the close of the Hearing the OSC was continuing its investigation into the matter. The Board, therefore, makes no finding as to the fairness of the treatment of shareholders, but draws the importance of this matter to the attention of the Lieutenant Governor.

9. SUBJECT MATTERS FOR REGULATION

9.1 At the hearing, strong and significant evidence was presented by many witnesses that caused the Board to examine not only its role during a transfer of ownership or control of a gas utility, but also its regulatory powers in general. In particular, the Board examined from first principles the regulatory function (and the Board's role in that function) with regard to a number of key areas of concern. These are areas of concern which should be considered at the time of any takeover or change of control of a natural gas utility. This examination also included a consideration of the ongoing responsibilities and authority of the Board.

9.2 In this chapter, these key areas of concern are considered in relation to the joint undertakings offered by Unicorp and Union Enterprises. The over-riding questions of the status, monitoring and enforcibility of all the undertakings which have been offered from time to time by the holding companies controlling the three major natural gas utilities, are considered at the end of the chapter.

9.3 Before considering the joint undertakings in relation to the key areas of concern it should be noted that the joint undertakings of Unicorp and Union Enterprises contain, in the Board's view, some underlying weaknesses.

i) The joint undertakings are dependent in part upon the definition of the word "control" which is defined therein as follows:

> 1. Definition of Control
>
> For the purposes of this undertaking "control" shall mean the right directly or indirectly to elect a majority of the directors of a corporation whether by ownership of shares, contract or otherwise and "controlled" shall have a similar meaning.

This is not a satisfactory definition to the Board as it rests on the words "the right to elect ...." Effective control may be established regardless of the right to elect a majority of directors.

ii) The joint undertakings, while addressed to the Lieutenant Governor, have never been offered to nor accepted by the Lieutenant Governor. It is the Board's view, as discussed later in this chapter, that the undertakings as structured may be invalid except as between Union Enterprises and Unicorp.

iii) The joint undertakings rest upon Unicorp voting its shares in Union Enterprises and Union Enterprises then voting its shares in Union Gas to bring about the undertakings. However,

  a) there could be a considerable time lag in bringing about such a mandate;

  b) since the undertakings provide for an independent board of directors for Union Gas in which the combined Union Enterprises and Unicorp nominees are in the minority, such assurance cannot be guaranteed.

iv) When Union Enterprises reorganized itself as of January 1, 1985, it gave undertakings to the Lieutenant Governor which are set out in Appendix D. These undertakings are adopted by Unicorp in the joint undertakings. The Union Enterprises undertakings referred to five subject matters:

a) Indebtedness, guarantees, etc.;
b) Equity of Union Gas;
c) Change or Potential Change of Control;
d) Cost of Reorganization, and,
e) Management Costs.

Some of the undertakings are imprecise and for that reason may be difficult to enforce. Overall, these Union Enterprises' undertakings do not, in the Board's view, adequately address the areas of regulatory concern.

v) Having noted the clauses in the Settlement Agreement between Unicorp and Union Enterprises relating to termination and to encumbrance of Unicorp Securities, the Board recommends that there be added to the joint undertakings a commitment that in the event that the Agreement is to be altered or terminated, notice shall be given to the Ontario Energy Board.

9.4 The key areas of concern relating to the Board's regulatory function which were raised by the Unicorp/Union Enterprises transaction and discussed during the hearing are as follows:

1. Indebtedness of the utility;
2. Intercorporate loans and investments;
3. Diversification;
4. Affiliated transactions;
5. The capital structure;
6. The board of directors;
7. Location of head office;
8. Common share float;
9. Joint and common costs;
10. Change in control;
11. Reorganization costs, acquisition premiums and acquisition costs;
12. Quality of service.

This chapter discusses each of the above subjects under three headings:

(a) the Board's view,
(b) the joint undertakings proposed by Union Enterprises/Unicorp, and
(c) the Board's conclusion.

In order to deal with the following key areas of concern other than during a takeover or at a rate hearing, it will be necessary to make certain amendments to the Ontario Energy Board to effect such authority.

Indebtedness of the Utility

9.5. The Board's View: The debt capacity of a utility should be reserved for utility-related activities. This means that the utility should not borrow for the purposes of a parent or grandparent holding company, nor should the utility's credit be used indirectly by them.

9.6 The Joint Undertakings:

> 2. Indebtedness of [Union] Gas.
>
> Gas will not become responsible for the indebtedness of Unicorp, Union Enterprises, Union Shield Resources Ltd. ("Resources"), Burns Foods Limited or any other 'affiliate' (as defined in the Business Corporations Act (the "OBC Act")) of Gas, except for subsidiaries of Gas that are subject to regulation under the O.E.B. Act, without the prior consent of the Ontario Energy Board.

9.7 The Board's Conclusion: The above undertaking is satisfactory to the Board.

Intercorporate Loans and Investments

9.8 The Board's View: The utility should not lend money or make investments except for utility-related purposes without the leave of the Board. The Board would grant exemptions for loans to employees and officers to purchase shares in the company, or to accomodate employee relocation, etc.

9.9 The Joint Undertakings:

> 3. Loans and Investments by Gas
>
> [Union] Gas shall not borrow for, make loans or advances to, guarantee the obligations of or otherwise assume or become responsible for the obligations of Unicorp, Union Enterprises, Resources, Burns Foods Limited or any other affiliate of Gas, except for subsidiaries of Gas that are subject to regulation under the O.E.B. Act, without the prior consent of the Ontario Energy Board.

9.10 The Board's Conclusion: The above undertaking is satisfactory.

Diversification

9.11 The Board's View: Because the three major natural gas utilities are mature industries, they have limited opportunities to expand their pure utility activities within their franchised areas and consequently they have expanded in non-utility activities. In some cases these activities are undertaken by separate companies, whether subsidiaries of the utility or sister or parent companies within a holding company structure. Nonetheless, the utility companies have not always been kept "pure" in the sense of having no non-utility activity whatever.

A pure utility may not be the ideal corporate entity for the particular economic circumstances. The Board's difficulties relate to such questions as cross-subsidization of non-utility activities by the utility, captive markets, capital structures and overleveraging, all of which ultimately could adversely effect the rates charged to customers and the quality of service.

It was argued at the hearing that the Ontario Energy Board has authority to create a hypothetical capital structure with which to free the customer from the burdens of cross-subsidization. With respect to diversification, the hypothetical capital structure has been used with limited success as a rate-making tool to isolate utility financing, but can do little to correct potential areas of cross subsidization.

However, if diversification is restricted to the subsidiaries and the holding companies of utilities, then the Board need only approve the withdrawal of funds from the utility or the use of utility credit to support non-utility activity; the problems with approving a particular diversification or purging after the fact disappear. The Board's focus would remain on the utility alone.

9.12 The Joint Undertakings: The joint undertakings deal with this subject only in part as set forth in paragraphs 2 and 3 of the undertakings as quoted above and in paragraph 5 which reads as follows:

> 5. Regulated Activities
>
> All current and future regulated utility activities under the control of Unicorp or Union Enterprises and governed by the O.E.B. Act will be maintained in Gas or a subsidiary thereof unless the Ontario Energy Board otherwise determines.

9.13 The Board's Conclusion: The undertakings are not satisfactory because they do not deal with the utility's investment in non-utility and unregulated activities. Therefore, the Board recommends that the undertaking set out as paragraph 5 of the joint undertakings be rewritten to disallow any diversification within the utility without the prior approval of the Board.

Affiliated Transactions

9.14 The Board's View: Affiliated transactions are transactions between members of the holding company family. At the hearing the Board heard much evidence relating to the control of such transactions. A clear example would be where a utility buys products or services from a subsidiary or from the parent, grandparent or a sister corporation. The danger for utility customers is that the price or cost might be in excess of what the utility would pay in the open market. This is what is known as a "sweetheart deal". If the utility pays more than the market price for a product or service, this would ultimately lead to unduly increased rates for customers. Therefore, affiliated transactions should require the prior approval of the Board. It is not expected that the problem will arise frequently but, for example, the Board can clearly see the possibility of such transactions occuring within holding company structures that include the natural gas utilities. However, the Board also recognizes that prudent management may well enter into into affiliated transactions which will be beneficial to customers. The objective is for the Board to be informed in advance, and it could approve any affiliated transaction without a hearing.

9.15 The Joint Undertakings: There is no reference to affiliated transactions in the joint undertakings.

9.16 The Board's Conclusion: The Board recommends that the joint undertakings be enlarged to forbid affiliated transactions without the prior consent of the Board, which consent could be given without a hearing.

The Capital Structure

9.17 The Board's View: The capital structures of the three natural gas utilities differ because each utility has its own history and special set of circumstances, not to mention differing managerial objectives. The capital structure (the proportions of debt and preferred and common equity) is a major factor influencing the riskiness of a utility. Risk impacts upon the ability of the utility to attract common equity capital, the cost of capital and consequently the level of customer rates. The common equity ratio is directly affected by the level of retained earnings, the dividend payout ratio and the mix of capital financing. All these essential elements are considered by the Board in setting rates.

Major changes in the capital structure of a utility should therefore not be implemented without the approval of the Board, which should have the power to approve or refuse the change with or without a public hearing. A public hearing would not normally be necessary, and only in an extreme case would the Board interfere. The Board is of the opinion that the cost of capital will not be increased if major capital structure changes are approved by the Board before they are undertaken, nor will delay result.

While the Board presently monitors the capital structure of each utility, the best the Board can do during the course of a regular rate hearing, is to provide an incentive to reduce an excessively high equity level. By deeming a capital structure that includes less equity than that which actually exists, the Board provides an incentive to remove that excess equity. A company will be inclined to remove that equity on which it is only receiving a return commensurate with debt. It does not follow, however, that by deeming an equity level that is higher than that which actually exists, the Board will provide an incentive to the utility owners to inject additional equity. Thus the power to require a parent or grandparent holding company to invest necessary capital in the utility is a necessary corollary power that should be granted to the Board.

While the Board hopes that during the course of public rate hearings it can induce a company to reverse a series of incremental changes that are leading to an inappropriate capital structure, if this approach fails, the Board will have to be able to adopt regulations that will directly effect dividend policy and the issuance of new securities. Dividend stripping or excessive leverage will not be permitted.

9.18 The Joint Undertakings: The joint undertakings deal with the matter of capital structure as follows:

> 4. Financing of Gas
>
> For three years from the date hereof, [Union] Gas will not increase its aggregate common share cash dividend beyond $27,000,000 per annum (plus an appropriate amount to reflect any additional common equity investment in

Gas) plus an amount equal to the dividend received by Gas in respect of its holding of preference shares of Resources. Nor will Gas otherwise reduce shareholders' equity by way of redemption or purchase of common shares for cancellation if the effect would be to reduce the shareholders' equity of Gas below that used to determine rates in the most recently decided Gas rate case before the Ontario Energy Board from time to time.

Unicorp, Union Enterprises and Gas will cause such portion of the current and future earnings of Gas to be retained in Gas as is from time to time appropriate for retention by a gas distribution utility regulated by the Ontario Energy Board, and to the extent that such retained earnings are not or are expected not to be sufficent to maintain the equity of Gas (for this prupose, equity shall include both common and preferred shares) at a level from time to time deemed appropriate for Gas by the Ontario Energy Board, Gas will be permitted to raise equity at the times and in the manner considered prudent by its Board of Directors. If Enterprises or Unicorp through Union Enterprises wish to provide Gas with additional equity capital, they may only do so on terms at least as favourable to Gas as Gas could itself obtain directly in the capital markets.

Unicorp through Union Enterprises, or Union Enterprises may provide financing to Gas but only on terms no less favourable to Gas as Gas could itself obtain directly in the capital markets. In

> the event Unicorp or Union Enterprises is unable or unwilling to supply such financing, Union Enterprises and Unicorp agree and undertake to permit Gas itself to raise financing from other sources, including the issuance of securities to the public.

9.19 The Board's Conclusion:

1. The Board views the $27,000,000 ceiling on dividends as unnecessarily restrictive.

2. The capital structure constraint is limited to "the most recently decided [Union] Gas rate case ... from time to time". This is not satisfactory because the undertaking should provide that the shareholder equity will not be reduced below that permitted by the Board regardless of any rate case.

3. If the shareholder equity falls below a required level, the joint undertakings authorize Union Gas to raise equity on its own in the market. This is not a satisfactory provision to the Board. It may not be possible for Union Gas to do a small equity issue and in any event it might cost too much. The joint undertakings should, in the Board's view, require Union Enterprises and Unicorp to invest the needed

capital if Union Gas satisfies the Board that it cannot do so or can only do so at an unreasonable cost. This requirement is especially relevant in light of the problems created by the preferred share interlock as discussed in chapter 8.

The Board of Directors

9.20 The Board's View: Irrespective of the provisions in the Ontario Business Corporations Act, it is essential to have an independent Board of Directors for each utility.

9.21 The Joint Undertakings:

> 7. Board of Gas
>
> Members of the Board of Directors of [Union] Gas shall consist of:
>
> (a) eight directors (the "Unrelated Directors") nominated by those directors of Union Enterprises elected by the shareholders of Union Enterprises other than Unicorp. The Unrelated Directors shall consist of persons who are not officers, directors or employees of and who have no pecuniary interest in Unicorp, Union Enterprises, any corporation controlled by either of them, any affiliate of either of them or any utility

company (other than Gas) governed by the OFB Act (other than the ownership of shares of any such corporation representing less than one-half of 1% of the outstanding shares of any class of any such corporation). Not more than two of the Unrelated Directors may be officers or employees of Gas;

(b) five directors (the "Joint Directors") nominated by the Board of Directors of Enterprises. Not more than two of the Joint Directors may be officers, directors or employees of Unicorp, Union Enterprises or any corporation controlled by either of them or any affiliate of either of them (other than Gas); and

3. two directors (the "Other Directors") nominated by Unicorp who may be officers or employees of Unicorp.

Enterprises undertakes to vote its shares of Gas to elect as directors of Gas the persons nominated as above, and Unicorp undertakes to vote its shares in Union Enterprises to cause Union Enterprises to so vote its shares in Gas.

The Directors of Gas shall have all the usual powers of directors under the O.E.B. Act, provided all transactions between Gas or any corporation controlled by Gas on the one hand and Unicorp, Union Enterprises or any corporation controlled by either of them or any affiliate of either (other than Gas

> or any corporation controlled by Gas) on the other hand shall be subject to the approval of a majority of the Unrelated Directors.
>
> At least 40% of the directors of Gas shall be resident in the franchise area of Gas.
>
> If it is determined that the efficient management of Gas would be best served by a Board of Directors of a different size, the respective number of Unrelated Directors, Joint Directors and Unicorp Directors shall be increased or decreased proportionately as the case may be, provided that in no event shall Unrelated Directors constitute less than 51% of the Directors of Gas.

9.22 The Board's Conclusion: The joint undertakings as to directors are satisfactory.

Location of Head Office

9.23 The Board's View: The location of the head office is a very important matter to the customers and to shareholders of Union Enterprises who live in the service area of Union Gas. The Board is of the view that the location of the head offices of any utility should not be changed without the approval of the Board. At present, there are different circumstances for Consumers' Gas and Northern and Central, the head office locations of which do not seem to be as important as that of Union Gas. The head office of Union Gas should be situated in Chatham unless otherwise ordered by this Board.

9.24 The Joint Undertakings:

> 9. Head Office
> The head office of Gas and all appropriate head office operations will be maintained in the City of Chatham.

9.25 The Board's Conclusion: This is satisfactory to the Board unless a new location is approved by the Board.

Common Share Float

9.26 The Board's View: The Board has heard arguments in favour of a common share float on the grounds that this would give the Board a better understanding of the market's perception of the utility's stock value and thereby aid it in determining the cost of common equity capital; moreover, by having established a presence in the market, it could be easier for the utility to raise additional common equity if required. It was argued that each utility should have some of its shares owned by the public as has

Consumers' (about 10 percent). The Board cannot recommend a float in this case because of the complications involved in forcefully taking some of the ownership away from present shareholders, the unfairness, the cost, and the questionable value of such a forced float. There is no problem with the existing float of Consumers' nor would there be if the other companies wished to create common share floats on their own initiative.

9.27 The Joint Undertakings and The Board's Conclusion: There is no provision for a common share float, nor, in the opinion of the Board, need there be one.

Joint and Common Costs

9.28 The Board's View: Allocating joint costs and joint benefits among associated companies or among utility and non-utility activities is an involved and contentious problem with which regulatory Boards have struggled for years as a matter of continuing practice. At this time the Board prefers to remain flexible, so that it may continue to use its best judgment regarding the allocation of costs and benefits between customers and shareholders. With a "stand-alone" utility one attempts to segregate costs as best one can. The more varied, integrated and expansive in scope the utility, the more difficult joint cost allocation becomes.

9.29 The Joint Undertakings: The joint undertakings adopt the undertakings given by Union Enterprises at the time of its reorganization.

9.30 The Board's Conclusion: These latter undertakings deal with the matter satisfactorily because it is subject in any event to the Board's authorized regulatory powers.

Change in Control

9.31 The Board's View: At present, the restrictions regarding the change of control of a utility are expressed in section 26 of the OEB Act, which requires leave of the Lieutenant governor for a change of ownership of more than 20 percent of the shares of the utility. As discussed in detail in chapter 10, this section does not at present provide for an indirect change of ownership, i.e., a change of control of the utility's holding company. (Thus, when Unicorp was asked informally on behalf of the government to delay executing the takeover, it declined to do so, recognizing that there was no legislation requiring it to comply.)

Some of the existing undertakings from the holding companies of the other two major natural gas utilties provide for giving notice to the Minister of Energy or the Lieutenant Governor of an impending change of ownership. In the Board's view this notice should also be given to the Ontario Energy Board, since the Board must monitor such a change. However, it should be added that without the power to respond to such a notice of impending change of ownership, little is accomplished by giving the notice.

9.32 The Joint Undertakings:

> 6. Change of Control.
>
> The Ministry of Energy will be notified of any potential change of control of Union Enterprises or Unicorp."

9.33 The Board's Conclusion: This undertaking should be amended to include the Ontario Energy Board.

Reorganization Costs, Acquisition Premiums and Acquisition Costs

9.34 The Board's View: Reorganization costs have no part in a utility's cost of service unless they are clearly demonstrated to be in the best interests of the customer.

Acquisition premiums incurred by a parent or grandparent holding company of a utility must not be included in a utility's cost of service. In the course of the Unicorp takeover of Union Enterprises, acquisition premiums arose out of the purchase of Union Enterprises by Unicorp and out of the purchase of Burns Foods by Union Enterprises. These were extensively analysed in chapter 8.

Acquisition costs incurred by a parent or grandparent holding company of a utility must not be included in the utility's cost of service. Acquisition costs asssociated with Unicorp's acquisition of Union Enterprise shares were not adequately quantified during the hearing as a number of the significant costs were not known before the hearing had concluded. Such costs would include legal, consulting, advertising and public hearing expenses incurred by both companies. Unicorp's evidence was that none of their costs associated with the acquisition will be included in the utility rate base or cost of service of Union Gas since these costs will be borne by Unicorp. Union Enterprises gave a similar assurance that it would not be appropriate to include such costs in the cost of service.

9.35 The Joint Undertakings:

> 8. Acquisition Premium.
>
> No part of the premium arising on the acquisition of shares of Union Enterprises by Unicorp shall be added to the rate base of Gas.

9.36 The Board's Conclusion: This Undertaking should be amended to include acquisition costs and reorganization costs and by adding the words "or recovered in the cost of service".

Quality of Service

9.37 The Board's View: Quality of service refers to the level of service that the gas utility offers to its customers. When the Board fixes rates it assumes that a good quality of service will be maintained by the utility, and if it is not maintained, it is the duty of the Board to see that it is accomplished. Rates must be fixed at a high enough level to allow the utility to assure good quality customer service. Every witness who testified regarding the regulatory role of this Board advocated that the Board has a duty to assure quality of service.

9.38 The Joint Undertakings: There is no provision dealing with quality of service.

9.39 The Board's Conclusion: The Board believes that it has the authority under the OEB Act to deal with quality of service.

THE STATUS OF UNDERTAKINGS

9.40 Whenever the control of one of the three major natural gas utilities in Ontario has changed hands, undertakings as to the future conduct of the parties have been given by the holding company as an assurance of how the utility will be managed and financed in the future. These sets of undertakings are:

1. Newco in the matter of the takeover of Northern and Central Gas Corporation Limited (August 15, 1975);
2. Hiram Walker - Consumers Home Ltd. upon reorganization (April 21, 1981);
3. Inter-City Gas Corporation, ICG Resources Ltd., Vigas Propane Ltd. and Northern and Central Gas Corporation Limited in the matter of the takeover (January 18, 1985);
4. Union Gas Limited and Union Enterprises Ltd. upon reorganization (December 14, 1984);
5. Unicorp Canada Corporation and Union Enterprises Ltd. in the matter of the takeover

(1985 - the Joint Undertakings as discussed in this chapter).

9.41 The texts of these undertakings, together with the related Orders in Council are presented in Appendix D in Volume II of this report.

9.42 Throughout the hearing the Board observed that three assumptions were made by participants with respect to undertakings:

i) That the past and proposed undertakings are valid in law;
ii) That the undertakings are being and can be monitored;
iii) That the undertakings can be enforced.

Validity of Undertakings

9.43 This Board has concern whether the past undertakings, as well as the joint undertakings now under consideration, are valid in law because there may be no legal consideration for such undertakings.

9.44 Inherent in the Unicorp/Union Enterprises joint undertakings is the concept that the Lieutenant Governor will not reverse the Unicorp transaction. This may fetter the duty of the Lieutenant Governor and the Legislature. Therefore, the undertakings may be contrary to public policy in that they may restrict the powers of the Lieutenant Governor or the OEB under the OEB Act. Undertakings that are against public policy may be void or may be voidable whether they are under seal or not.

Monitoring and Enforcing Undertakings

9.45 Despite the assumptions evident at the hearing, the Board doubts whether the existing undertakings are being monitored. No evidence was given that the past undertakings are being monitored and the Board questions whether there is a body with the power or structure to monitor or to enforce them.

9.46 Regarding the past undertakings and related Orders in Council, it is difficult to associate the Lieutenant Governor with all of them and he is not a party to the proposed undertakings.

9.47 The Ontario Energy Board is not a party to any of the undertakings, and responsibility for monitoring or enforcing them has not been delegated to the Board. The specifics of many of the undertakings do not come within the powers granted to the OEB for the fixing of rates. Furthermore, the OEB's power to fix rates is probably the most indirect and ineffective way of monitoring undertakings.

9.48 For undertakings to be enforcible,

- they must be valid;
- the enforcer must have the appropriate authority;
- the undertakings must be in a form that is enforcible.

9.49 It might seem practicable for the Lieutenant Governor to assign his rights to monitor and enforce the undertakings to the Ontario Energy Board. However, it is possible that the Lieutenant Governor has no right in law to assign or to enforce the past or proposed undertakings.

9.50 A court of law would have difficulty enforcing the undertakings because they deal with complicated, on-going, judgmental issues which can change frequently. A court, if it ordered anything, might make an order of damages, but it would be difficult to prove who was damaged and to what extent.

9.51 If the Government wishes the past and proposed undertakings to be monitored and enforced by the Ontario Energy Board, the OEB Act should be amended accordingly.

Recomendation:

9.52 The existing undertakings relating to Consumers' Gas, Northern and Central Gas and the proposed joint undertakings of Unicorp and Union Enterprises relating to Union Gas should be supplemented by the government with an amendment to the Ontario Energy Board Act so that the respective undertakings are equivalent to orders of this Board and enforcible as such. In enforcing the undertakings, the Board would be deemed to have had and to have jurisdiction to make such orders now and in the future.

10. LEGISLATION IN ONTARIO AND IN OTHER PROVINCES RELATING TO THE CONTROL OF NATURAL GAS UTILITIES

10.1 The order in council in its second item requires the Ontario Energy Board to examine and, after holding a public hearing, report on "the need for or desirability of the public review and regulation of both the direct and indirect ownership and control, and transfers thereof, of gas distributors and transmitters in Ontario." In this chapter the Board examines:

1. the background to the current Ontario legislation regarding changes of control in natural gas utilities;
2. the various changes of control in the utilities and the government's response to these changes;
3. the existing comparable legislation in other provinces.

Background to the Ontario Legislation

10.2 When the Ontario Energy Board Act was introduced in 1960 as a replacement for the existing Ontario Fuel Board Act, it made no provision for changes in ownership of a gas utility. At that time, all three major Ontario natural gas utilities were broadly held, independent corporations.

10.3 However, early in 1969, concern about the ownership of a gas utility arose when Consumers' Gas offered to buy all of the assets of Union Gas. Reacting to that offer, the government of the day introduced, in March 1969, a bill that altered the Ontario Energy Board Act to require that all gas utility mergers be approved by the Lieutenant Governor. In the fall of 1969 Consumers' changed its offer to buy the assets to an offer to buy the shares of Union Gas.

10.4 On October 23, 1969, the Government amended and tightened up the unenacted March, 1969 amendment by introducing Bill 109 which was enacted on October 31, 1969 as follows:

25(a)

(1) No gas transmitter, gas distributor or storage company, [changed in 1973 to "no

person"] without first obtaining the leave of the Lieutenant Governor in Council, shall,

(a) sell, lease, convey or otherwise dispose of its gas transmission, gas distribution or gas storage system, or any part thereof that is used or useful in serving the public, as an entirety or substantially as an entirety;

(b) amalgamate with any other company; or

(c) acquire such number of any class of shares that, together with shares already held by the gas transmitter, gas distributor or storage company and its associates will in the aggregate exceed 20 percent of the shares outstanding of that class of a gas transmitter, gas distributor or storage company.

(2) Subsection 1 does not apply to a mortgage or charge to secure any loan or indebtedness or to secure any bond, debenture or other evidence of indebtedness.

(3) An application for leave under subsection 1 shall be made to the Board, which shall hold a public hearing and submit its report and opinion to the Lieutenant Governor in Council.

10.5 In light of to-day's circumstances the legislation appears to suffer from two major shortcomings:

(i) the section deals with acquiring "shares" rather than control;

(ii) the section does not deal with the change in control of a holding company that controls a gas utility.

10.6 Section 25(a) [now Section 26(2)] was passed retroactively, in that it was deemed to come into effect on a day before it received Royal Assent. Section 25(a) therefore enabled the Lieutenant Governor to refer the Consumers' takeover offer for Union Gas to the Ontario Energy Board. When the acquisition was considered by this Board it was rejected as not being in the public interest. (E.B.O. 36, July 6, 1970).

10.7 It is important to try to discern the purpose for which section 25(a) was introduced. Normally, when one reviews the reasons for which the Legislature acted, one can be assisted by

(i) the marginal notes which accompany the text of the written Bill when it is introduced in the Legislature;

(ii) the debates in the legislature at the time the Bill was introduced.

10.8 The marginal note opposite section 25(a) reads "the section is self-explanatory".

10.9 More illuminating are the statements made when the Bill was introduced in the legislature as recorded in Hansard. Mr. Kerr, the Minister who introduced the Bill, said on October 22, 1969 (page 7730),

> ...if we wish the energy board to review mergers or amalgamations, it is also necessary to review in the public interest the purchase of majority shares as provided in the new subsection c.

10.10 Mr. Kerr, discussing the Bill on October 23, 1969, said (pages 7471 through 7474)

> ...because of the public interest in this bill and in the legislation, the government considered the advisability of extending the legislation to cover majority stock take-overs in this industry.
>
> Because of the transaction involving two of the province's three major gas distributors, it is now essential that this bill that is before the

House, with the amendment proposed, be approved so that the Energy Board will have an opportunity to review this transaction at a public hearing and report accordingly.

...The bill before us, Mr. Speaker, will extend the Board's powers to assure that any sale, merger, amalgamation, or stock take-over, majority stock takeover, will in fact be in the public interest.

...we are primarily concerned with the sale of gas distribution companies, with mergers, and with amalgamations.

But why should we be concerned, really over who has control? What we are concerned with under The Energy Act is the operation of the system. This is what we are concerned with, and as far as that is concerned, Mr. Speaker, the existing legislation in the province of Alberta, and in the province of British Columbia, provides for the same percentage - over 50 percent is referred to in both Acts.

[Note: When the Bill was first introduced into the Ontario Legislature the figure was 50%. This was subsequently reduced to 20%. The B.C. and Alberta legislation have been subsequently amended.]

We feel that a stock take-over, for example of over 50 per cent and certainly of 100 percent as is offered in this particular transaction, is in fact an amalgamation. This is what we are worried about.

> In the case of a public hearing which would be held under the provisions of this Act, every detail of a transaction of this kind could be considered by the Board. Anybody from a municipality, another gas company or a customer can appear before this board and be heard before the Board to object or otherwise. Since my view, appearing before a Board that is expert in the matters dealing with gas distribution companies--which is something theyare doing continuously--would be much more effective, reasonable and adequate than a standing committee of the Legislature.

10.11 This Board, having read Hansard for the period when the Bill was debated, and after having heard counsel in this hearing, has reached the following conclusions:

(1) the Legislature was concerned about the control of one major gas utility passing to another gas utility. (In this hearing such a transfer of control has been called "horizontal" integration as opposed to "vertical" integration.)

(2) the Legislature was concerned as well that such a change of control should not take place without a public hearing.

(3) some legislators were concerned about possible "foreign" control of an Ontario

gas utility.

10.12 In 1969 no major gas utility in Ontario was owned by a holding company. It is apparent from reading Hansard that the legislation of 1969 was not enacted in contemplation of a holding company owning an Ontario gas utility, much less of the control of holding companies being passed around.

10.13 Mr. Paddon persuasively argued at the hearing, in another connection, that legislation should generally be interpreted as being remedial. If that is so and the Board believes that he is correct, then one can reasonably conclude that section 25(a) [now 26(2)] was introduced to remedy a developing situation as then perceived, namely the takeover of one gas utility by another.

10.14 It is the Board's view from reading Hansard, that the government of the day intended to keep within its purview in the future, the question of control of Ontario gas utilities.

10.15 In 1973 the Legislature amended the section by broadening the description of the "taker" from a gas distributor etc. to "no person". There was no discussion in the Hansard debate of 1973 on the amendment when it was introduced, but a marginal note of Bill 133 itself stated:

> "The existing section only applies to gas transmitters, distributors and storage companies. As amended, the section will apply to any person."

Changes of Control and Government Response

10.16 The 1969 legislation was created in response to the proposed takeover of Union Gas by Consumers' Gas. As a consequence of the legislation, the Ontario Energy Board held a hearing and, in its report to the government, recommended against approving the takeover. The government accepted the recommendation and the takeover did not go through.

10.17 In 1969, when section 25(a) [now 26(2)] was passed by the legislature, all three major Ontario gas utilities were broadly owned and therefore broadly controlled. None was owned or controlled by a holding company. Since 1969 there have been several changes in the structure of ownership and control of gas utilities in Ontario and now all of the gas utilities are controlled by holding companies.

10.18 The following is a summary of these changes in the control and structure of control of Ontario gas utilities since 1969 and the government's response to them in relation to Section 25(a) [now section 26(2)] of the OEB Act.

1. In 1975 Northern and Central and Norcen Energy Resources Limited ("Norcen") reorganized to establish Norcen as a holding company with Northern and Central as a subsidiary. A hearing was held by the OEB and the Board recommended approval of the reorganization, with some conditions.

2. In 1980 Consumers' Gas and Hiram Walker carried out a reorganization which ultimately created Hiram Walker Resources as a holding company and Consumers' Gas as a subsidiary. This reorganization did not involve a real change in control of the gas utility. The Minister of Energy was informed, but there was no hearing, and the reorganization was approved.

3. In 1984 Norcen sold its interest in Northern and Central Gas to Inter-City gas. This sale did involve a real change in the direct ownership and control of Northern and Central - more than 20 percent of the shares of the utility were being purchased.

A hearing was held by the Board and the change of ownership was approved with various conditions.

4. In 1984 Union Gas proposed to reorganize itself into a holding company (Union Enterprises) and two subsidiaries, Union Gas and Union shield Resources. This reorganization did not involve a real change in ownership or control of Union Gas. The reorganization was approved with certain conditions.

10.19 From this history the Board draws two conclusions:

i) Until the acquisition of Union Enterprises by Unicorp there has never been an indirect real change of control of a gas utility in Ontario through the change in control of a holding company which controls a gas utility.

ii) It is clear to the Board that the Government expects to be consulted through the Lieutenant Governor, PRIOR to a change in control of gas utility and that the gas industry recognizes this. It is also clear that present Ontario legislation does not provide for indirect but real changes of control in a utility, a situation recognized by Unicorp when it proceeded with its takeover of Union Enterprises.

Legislation in Other Provinces

10.20 How do the other provinces constrain transfers of control of their non-government owned utilities?

10.21 British Columbia: Section 60 of The Utilities Commission Act prohibits without consent of the Lieutenant Governor, the consolidation, amalgamation or merger of a utility. Any consent requires a report from the Commission that the change is in the public interest. Section 61 of the same Act prohibits acquisition of 20 percent of the voting shares of a public utility without prior approval of the Commission.

10.22 Alberta: By virtue of section 92 of The Public Utilities Board Act and section 26 of The Gas Utilities Act there is a prohibition of the sale of over 50 percent of the capital stock of a gas utility. Section 99 of The Public Utilities Board Act prohibits without Board approval the uniting of two public utilities. (Note that in the case ATCO v. Calgary Power, 1983, 140, D.L.R. (3d), p. 193, the Supreme Court of Canada traced the owner up to the grandparent and defined owner as one with control).

10.23 Saskatchewan: There are no constraints in that province concerning the transfer of control or the amalgamation of a utility.

10.24 Manitoba: Sections 82 and 92 of The Public Utilities Board Act forbid the sale of a utility or the merging of two utilities without the Board's approval.

10.25 Quebec: Section 44 of An Act Respecting the Regie de l'Electricite et du Gaz prohibits the disposal of shares of a gas distributor, which would concentrate over 50 percent in another person, without the approval of the Board.

10.26 New Brunswick: There is no legislative prohibition, but the Public Utilities Board is required, by section 33(1) of the Public Utilities Act, to approve any issue of shares by a public utility.

10.27 Nova Scotia: By section 13 of The Gas Utilities Act, proclaimed to come into force on

July 28, 1984, the approval of the Lieutenant Governor in Council is required for any transfer of the shares which would result in the transferee having more than a prescribed percentage of the outstanding capital stock of the gas utility. To date, no percentage has been prescribed.

10.28 Prince Edward Island: Section 10 of The Electric Power and Telephone Act prohibits the transfer of a public utility without approval.

10.29 Newfoundland: Transfers in the case of Newfoundland are covered by The Public Utilities Act. According to section 47 no franchise may be assigned, transferred or leased without written approval of the Board. According to section 46 no public utility shall sell, assign or transfer the whole of its undertaking or any part thereof except with the approval of the Board.

10.30 It can be seen that all provinces except Saskatchewan have legislated to protect, to differing degrees, the ownership of their non-government-owned utilities. It would seem that in the provinces where there are investor-owned gas utilities (British Columbia, Alberta, Manitoba, Ontario and Quebec) there are constraints against the transfer of ownership (control in Alberta) of gas utilities or the merging of gas utilities. It would appear however that, with the exception of Alberta, other provincial legislation seems to suffer from the same shortcomings as that of Ontario (namely that the legislation does not specifically deal with the change of indirect control through the transfer of control of a holding company.) Alberta would appear to have attempted to remedy this shortcoming by its Gas Utilities Amendment Act, 1984, assented to on November 13, 1984, but not yet proclaimed. By that Act, both the Gas Utilities Act and the Public Utilities Board Act will be amended to require Board approval of any sales or transfers that would result in the vesting in a corporation of more than 50 percent of the outstanding capital stock of the "owner of" a gas utility. Depending on how "owner" is defined or interpreted, this may include a holding company.

Conclusion

The Government of Ontario has in the past maintained its right of prior review and approval of changes of ownership or control of Ontario's major natural gas utilities. This is a principle which is also recognized in most other Canadian provinces. The principle has been generally recognized and acknowledged by the natural gas utilities or their owners. The circumstances of a change of control of a utility by way of change of control of its holding company have not been provided for in the present Ontario Energy board Act, and if the Government wishes to retain its power of approval, then appropriate legislation is necessary.

11. APPROVAL PROCEDURE ON CHANGE OF CONTROL

11.1 The purpose of this chapter is to consider the best manner in which the Government can continue to exercise its concern for the change in control of a gas utility.

11.2 This Board was created in 1960 to fix just and reasonable rates and to see that natural gas is efficiently distributed in Ontario. To carry out its mandate the Board must consider a wide variety of factors, some of which are outlined in Chapter 9, including the cost and deployment of capital, management practices and future planning, to assure the lowest feasible cost to consumers. Therefore how each utility is operated, the goals of management and the structure of ownership and control are of substantial concern both to the Government and this Board.

11.3 Traditionally, the Government encourages the financial success of private and public enterprise, and it seldom interferes with the management and changes in control of industrial corporations. In the case of natural gas distribution monopolies, the government not only created regulation to review management, fairness of rates and corporate profitability, but also created legislation to protect the public interest and to deal with the change of ownership of gas utilities (Section 26(2) of the OEB Act). Therefore the control and management of the gas utilities is a constant public concern of the Government.

11.4 Upon any proposed change in control of a gas utility there should, in the Board's opinion, be a demonstration of the financial and managerial competence of those to be in control to carry out the obligations of the utility to serve the public efficiently and at fair rates.

11.5 Under the existing legislation, before 20 percent or more of any class of shares of a gas utility be acquired, the approval of the Lieutenant Governor must be obtained. This approval or disapproval is given following a public hearing before the O.E.B. unless the Lieutenant Governor has dispensed with a public hearing. In either case it is the Lieutenant Governor who approves or rejects the proposed change in ownership. In any event, Section 26(2) applies only to changes in direct ownership of the utility. It does not extend to the change in ownership or control of the company which owns the utility. This Board recommends that the existing pre-acquisition approval procedure for the change in control of an Ontario gas utility be retained and strengthened in order to extend to the change of control or ownership of holding companies controlling the utilities. In order to do this Section 26 should be amended.

11.6 At the hearing, the Board heard arguments for and against such an extension of the present pre-acquisition approval procedure, and the advantages and disadvantages are analyzed below.

Advantages:

11.7 If a change in control is not going to be approved it should be stopped or held up from the beginning in order to minimize costs, delay, inconvenience, damage to the customers and shareholders.

11.8 An already-effected change in ownership or control is difficult or impossible to reverse. A change that needs to be reversed may cause much damage to the utility directly or indirectly, in terms of expense, dislocation, increased cost of capital, increased risk, etc.

11.9 If the change is to be approved with conditions, those conditions should be known from the beginning, so as to permit the purchaser to withdraw if the conditions are considered by it to be too restrictive. The Government may not know until this Board investigates, either directly or through a public hearing, whether to approve the change in control or, if the change is to be approved, the conditions, if any, that should be imposed.

11.10 The Board believes that rather than have a set of general rules or conditions which must apply to every change of control of a utility, the conditions should be tailored to meet the requirements of each case. The three major natural gas utility companies each have different circumstances as do their various holding companies. One only needs to review the undertakings given in the past when change in control has taken place, to realize the virtue of tailoring the conditions to fit each case. Such a flexibility of regulation is only possible, and can only be fair to the parties if the approval and accompanying conditions are required before the completion of the acquisition.

11.11 At the present time there is an existing industry understanding of government and Board policy regarding change of control. A degree of predictability and certainty has developed in Ontario from the way in which the Lieutenant Governor has dealt with proposed changes in control up to the present. Evidence of this is suggested by the fact that Unicorp, without being required to do so, offered various undertakings upon making its offer to take over Union Enterprises. The question which is asked is: "What if Unicorp had not been willing to offer any protective undertakings?" In that event, it is the Board's view that neither the Lieutenant Governor nor this Board could have stopped the takeover or imposed appropriate conditions short of resorting to retroactive legislation.

11.12 The public, in the Board's view, should be encouraged to advance its views regarding a change in control of a gas utility before a change is effected. In the case of Union Enterprises/Union Gas, between one third and one half of the shareholders live in the franchise area, and many of the 505,000 customers are shareholders and employees. From the evidence presented to the Board, these residents believe that they have a right to be heard. They cannot be heard without a hearing, and a hearing after control has changed hands is not meaningful.

Disadvantages:

11.13 It was argued that a pre-acquisition approval procedure may be contrary to economic principles which support the free movement of resources and capital, thus leading to the most economic allocation of resources and keeping the cost of capital at the lowest possible level. The Board asked for but received no evidence that constraints on the change in control or ownership of an essential public service such as a gas utility, have caused the cost of capital to increase in Canada. In fact a spokesman for Inter-City stated that the pre-acquisition approval procedure which Inter--City followed when it purchased Northern and Central, had not increased its cost of capital.

11.14 It was argued that a pre-acquisition approval process, leads to ad hoc decisions which can create uncertainty and, consequently, to expense. However, there was no evidence that uncertainty has been created by previous decisions, or that the cost of capital has increased as a result.

11.15 It was argued that a pre-acquisition approval procedure is expensive and causes delay.

11.16 It was argued that a pre-acquisition approval procedure is not needed since the problems can be dealt with in the normal rate hearing process. The Board believes that it is important to emphasize the reasons why the normal rate hearing process is too late and too little to be effective in constraining or approving changes in control and ownership of natural gas utilities.

(a) A rate hearing takes place once a year or once every two years on average. If one had to wait two years before a takeover could be reviewed much less reversed, the damage could be incalculable and perhaps irreversible. Stopping a takeover is one thing, but reversing it is quite another.

(b) The rate hearing authority would require the power to reverse the takeover. Neither the Board nor the Government presently possesses this authority.

(c) A rate hearing does not focus on whether the acquiring company has the experience or financial stability to manage the utility, directly or indirectly.

(d) During a rate hearing the Board by law is limited to its powers under Section 19 and is limited by tradition to the historical principles of rate fixing. These powers and principles do not clearly enable the Board to review and order a response to the concerns outlined in Chapter 9.

11.17 The Board is convinced that a normal rate hearing is not an adequate forum for approval of change of ownership or control, and strongly recommends that the existing pre-acquisition approval procedure be extended and strengthened.

Recommendation

11.18 This Board recommends that the existing pre-acquisition approval procedure of the change in control of an Ontario gas utility be retained and strengthened. In order to do this, Section

26 of the Ontario Energy board Act should be amended. The amendment should ensure that the pre-acquisition approval procedure would involve the following steps:

1. No accumulation/acquisition of the voting shares of the utility, the parent or the grandparent of the utility, greater than 20 percent, should take effect without the approval of the Lieutenant Governor.

2. The proposed new owner must advise the Lieutenant Governor, the Minister of Energy and the O.E.B., of its intent to acquire such ownership or control of an Ontario gas utility.

3. At the direction of the Lieutenant Governor, the OEB would hold a public hearing into the matter and make recommendations relating to any conditions of approval.

4. The Lieutenant Governor would have the power under Section 35 to waive such a public hearing. It is the view of the Board however that public hearings in these circumstances are desirable. However, if there is to be no public hearing, the Board should be asked to recommend any

appropriate conditions of approval since it will have the duty to monitor and enforce the conditions.

5. The conditions of approval would be treated as an order of the Board and be monitored and enforced by it as such.

6. Any transfer without the approval of the Lieutenant Governor would be void.

12. SUMMARY OF RECOMMENDATIONS

The following is a summary of the Board's recommendations as they appear in the preceding chapters of the Report.

7. Holding Companies, Takeovers....

7.37 The Board recommends to the Lieutenant Governor that, subject to the other recommendations set forth in this Report, no action be taken to interfere with the takeover of Union Enterprises by Unicorp Canada Corporation.

8. Specific Findings

8.9 Since it would appear that there is doubt as to the Board's authority to require financial forecasts when necessary, the Board recommends that the Ontario Energy Board Act be amended to enable the Board to order that the necessary evidence be produced.

8.28 In order that the customers of Union Gas should not be exposed to the risk of Union Shield's failure to pay dividends or redeem its preference shares,

i) Union Enterprises and Unicorp should guarantee the payment of the preferred share dividend by Union Shield to Union Gas until the preference shares are redeemed.

ii) An undertaking should be given by Union Enterprises that, without the approval of the Board and until such time as the preference shares are redeemed, Union Enterprises will not permit any changes to the assets of Union Shield which underlie the preference shares.

8.30 An undertaking should be given by Union Enterprises and Unicorp that if the dividend from Union Shield to Union Gas becomes taxable, then the preference shares would be redeemed.

8.32 Union Enterprises and Unicorp should guarantee to Union Gas that if it is called upon to make good on its guarantee [as to interest and principle, $25 million of preferred shares issued by Precambrian to Fiberglas Canada] both companies [i.e. Union Enterprises and Unicorp] will indemnify Union Gas.

9. Subject Matters for Regulation

9.3 v) Having noted the clauses in the Settlement Agreement between Unicorp and Union Enterprises relating to termination and to encumbrance of Unicorp Securities, the Board recommends that there be added to the joint undertakings a commitment that in the event that the Agreement is to be altered or terminated, notice shall be given to the Ontario Energy Board.

9.4 [...In order to deal with some of the following areas of concern other than during a takeover or at a rate hearing, it will be necessary to make certain amendments to the OEB Act to effect such authority.]

9.13 The [Unicorp/Union Enterprises] joint undertakings are not satisfactory because they do not deal with the utility's investment in non-utility and unregulated activities. Therefore, the Board recommends that the undertaking set out as paragraph 5 of the joint undertakings be rewritten to disallow any diversification within the utility without the prior approval of the Board.

9.16 The Board recommends that the joint undertakings be enlarged to forbid affiliated transactions without the prior consent of the Board, which consent could be given without a hearing.

9.19 [In regard to the capital structure provisions in the Unicorp/ Union Enterprises joint undertakings:]

1. The Board views the $27,000,000 ceiling on dividends as unnecessarily restrictive.

2. The capital structure constraint is limited to "the most recently decided [Union] Gas rate case ... from time to time". This is not satisfactory because the undertaking should provide that the shareholder equity will not be reduced below that permitted by the Board regardless of any rate case.

3. If the shareholder equity falls below a required level, the joint undertakings authorize Union Gas to raise equity on its own in the market. This is not a satisfactory provision to the Board. It may not be possible for Union Gas to do a small equity issue and in any event it might cost too much. The joint undertakings should, in the Board's view, require Union Enterprises and Unicorp to invest the needed capital if Union Gas satisfies the Board that it cannot do so or can only do so at an unreasonable cost.

9.33 [The undertaking regarding change of control] should be amended to include the Ontario Energy Board.

9.36 [The undertaking regarding acquisition premium] should be amended to include acquisition costs and reorganization costs and by adding the words "or recovered in the cost of service".

9.52 The existing undertakings relating to Consumers' Gas, Northern and Central Gas and the proposed joint undertakings of Unicorp and Union Enterprises relating to Union Gas should be supplemented by the government with an amendment to the Ontario Energy Board Act so that the respective undertakings are equivalent to orders of this Board and enforcible as such. In enforcing the undertakings, the Board would be deemed to have had and to have jurisdiction to make such orders now and in the future.

11. Approval Procedure on Change of Control

11.18 This Board recommends that the existing pre acquisition approval procedure of the change in control of an Ontario gas utility be retained and strengthened. In order to do this, Section 26 of the Ontario Energy board Act should be amended. The amendment should ensure that the pre-acquisition approval procedure would involve the following steps:

1. No accumulation/acquisition of the voting shares of the utility, the parent or the grandparent of the utility, greater than 20 percent, should take effect without the approval of the Lieutenant Governor.

2. The proposed new owner must advise the Lieutenant Governor, the Minister of Energy and the O.E.B., of its intent to acquire such ownership or control of an Ontario gas utility.

3. At the direction of the Lieutenant Governor, the OEB would hold a public hearing into the matter and make recommendations relating to any conditions of approval.

4. The Lieutenant Governor would have the power under Section 35 to waive such a public hearing. It is the view of the Board however that public hearings in these circumstances are desirable. However, if there is to be no public hearing, the Board should be asked to recommend any appropriate conditions of approval since it will have the duty to monitor and enforce the conditions.

5. The conditions of approval would be treated as an order of the Board and be monitored and enforced by it as such.

6. Any transfer without the approval of the Lieutenant Governor would be void.

Ontario
Energy
Board

Ontario

In the matter of a
Reference respecting
Unicorp Canada Corporation/
Union Enterprises Ltd.

E.B.R.L.G. 28

REPORT OF THE BOARD

Volume II — Appendices

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E.B.R.L.G. 28

IN THE MATTER OF a reference pursuant to section 36 of the Ontario Energy Board Act, R.S.O. 1980, c.332 from the Lieutenant Governor in Council by Order in council dated the 15th day of February, 1985 to the Ontario Energy Board.

AND IN THE MATTER OF a public hearing to examine and report upon certain matters respecting the implications for energy supply, gas rates and service of a proposed acquisition of certain shares of Union Enterprises Ltd. by Unicorp Canada Corporation; and the question of the need for or desirability of the public review and regulation of both the direct and indirect ownership and control, and transfers thereof, of gas distributors, transmitters and storage companies in Ontario.

BEFORE: R. W. Macaulay, Q.C.
Chairman

D. A. Dean
Member

O. J. Cook
Member

August 2, 1985

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Mr. J. W. Leech

Mr. Leech, the President of Unicorp Canada Corporation, testified on the following major issues: the reorganization of Union Enterprises, the reasons behind Unicorp's takeover offer, Unicorp's managerial philosophy and financial strength, and the acquisition of Burns Foods.

Mr. Leech indicated that Unicorp was first attracted to Union Enterprises as a direct result of that company's corporate reorganization. A non-regulated holding company is perceived more positively by the investment community than is a regulated utility. This is due to the market perception of regulation as being a process which results in delay and uncertainty. This market perception impacts upon the investment risk by increasing financial risk which in turn increases the cost of capital to the utility and thereby results in depressed share prices. Therefore, when Union Gas restructured its business activities by segregating its utility from its non-utility operations a corporate structure was created which facilitated acquisition and diversification and which was at the same time positively perceived by the capital markets.

Five factors determined Unicorp's takeover decision. First, Union Enterprises shares were readily available on the open market. Second, the investment was consistent with Unicorp's entrepreneurial philosophy of expanding its tangible assets with a minimum amount of risk. Third, earnings from Union Gas represent a relatively stable source of income which would strengthen Unicorp's access to capital markets and accordingly its financial base. Fourth, the increased access to capital markets would stimulate expansion and would ultimately result in an increase in the share prices of Union Enterprises and Unicorp. Fifth, the reorganization increased Union Enterprises' diversification opportunities and Unicorp wished to take advantage of and to utilize its talent to further this expansion and thereby share in accompanying economic benefits.

Unicorp will help the management of Union Enterprises to design and execute the diversification program but will not alter its management structure. Nevertheless, Unicorp's nominees to the Board of Directors of Union Enterprises will play an active role in monitoring all operations including those of Union Gas. For example, Unicorp will use its proven record to raise capital in order to facilitate the utility's access to external capital markets. However, Union Gas will operate on a fully stand-alone basis, in that the company will be involved exclusively in utility operations, with its own management, without providing inter-corporate loans or guarantees of indebtedness, with an independent Board of Directors selected from representatives originating within the franchise area and with its own head office located in Chatham.

The purchase of Union Gas illustrates an extension of this new managerial style, because it represents a source of stable earnings. Mr. Leech said that this operating style

> ... is becoming more and more an aspect that we are concentrating on, basically because we see that the investment community likes to see a base of stable earnings underlying the growth pattern ... [therefore] our view is to combine ... a stable, weather-dependent and seasonal but somewhat predictable earnings [base] with our asset building concept. We think it creates a very exciting company.

Therefore, while Unicorp was originally conceived in 1979 as an asset rather than income oriented company it has since 1983 re-oriented its corporate philosophy by emphasizing operation and reportable income objectives.

Regarding Unicorp's financial strength and thus its ability to pay the dividend on the $1.17 preferred shares, Mr. Leech stressed the dynamic nature of the Unicorp group of companies. The cash flow within the group is made available to fund individual financial obligations. Further, Unicorp has access to substantial unutilized lines of credit.

Regarding the purchase of Burns Foods, Mr. Leech indicated that while the Burns Foods acquisition was found to be objectionable by Unicorp's Board of Directors, Unicorp had not formed an opinion as to whether the $125,000,000 acquisition was economically beneficial to Unicorp. He also added however, that in the event that the purchase turned out to be uneconomic, legal action against the Board of Directors of Enterprises would not be undertaken by Unicorp if the directors acted in good faith and with reasonable due diligence in entering into the Burns Foods transaction.

Mr. G. S. Mann

Mr. Mann, the Chairman of Unicorp Canada, addressed several issues of concern. Including the reasons behind the takeover of Union Enterprises, the Burns Foods acquisition, and the managerial philosophy, and financial strength of Unicorp.

Mr. Mann generally corroborated the evidence given by Mr. Leech. Regarding Burns Foods, he added that he had currently received several offers for the purchase of individual divisions of Burns Foods, and intimated that this company may be parcelled up and sold in the near future.

Mr. G. R. Cowan

Mr. Cowan, a Senior Investment Analyst with the investment firm of Levesque Beaubien Inc. was retained by Unicorp. He testified on the subject of Unicorp's financial condition and soundness prior to the takeover offer.

As of December 31, 1984 Unicorp's total interest-bearing debt comprised 48.9 percent of the capital structure as adjusted for after-tax appraised surplus. On the basis of this analysis Unicorp Canada was considered to be conservatively leveraged as compared to other Canadian public real estate companies. Generally, Mr. Cowan concluded that Unicorp Canada had successfully executed its corporate strategy of building asset wealth, and had done so on the basis of a prudently-financed capital structure.

Dr. C. J. Cicchetti

Dr. Cicchetti, the Vice President of National Economic Research Associates Limited and Professor of Economics and Environmental Studies at the University of Wisconsin was retained as an expert witness and appeared on behalf of Unicorp. He testified on matters relating to Phase I and Phase II issues.

His testimony regarding Phase I dealt with the impact of Unicorp's acquisition upon Union Enterprises and Union Gas. Particular emphasis was placed upon the effect of the acquisition on rates and quality of service offered to customers of Union Gas. Testimony in Phase II focused on two issues. First, the desirability of public review and regulation of direct and indirect ownership and transfers of control of a gas utility. Second, the desirability of introducing new rules intended to govern utilities and their affiliated interests (the "Affiliated Interest Rules").

In addressing Phase I matters Dr. Cicchetti concentrated on the impact of Unicorp's acquisition upon the rates and services provided to customers by Union Gas. Five key areas of regulatory concern were addressed; cross-subsidization, shifting of common costs, weakened credit ratings, lack of funds, and the treatment of non-utility losses.

On the matter of cross-subsidization between the utility and non-utility affiliates, an independent board of directors and ongoing regulatory review of Union Gas' expenditures during the rate case will ensure that all expenditures are just and reasonable.

Regarding the potential for a shifting of common costs onto the utility, since the utility and non-utility operations and accounting will be conducted on a stand alone basis any potential for abuse in this area is greatly reduced.

With respect to the credit rating of Union Gas, since bonds will be issued directly by Union Gas, the underlying capital condition of the holding company will not be evaluated, and accordingly the weak parent problem would not increase the cost of capital to the utility. However, a bond holder may be somewhat reassured by the strength of the parent and, over time, the cost of control to the utility may be reduced. Regarding equity capital, since the utility will be operated on a stand alone basis it will maintain the ability to issue shares independently from the holding company, and accordingly, the strength or weakness of the parent is not a relevant regulatory concern because it will have no effect upon the financial condition of the utility.

A lack of funds for necessary capital expansion generally results from the unwillingness of regulators to grant a sufficiently high rate of return on the utility's rate base. This problem is not present under current regulatory treatment within Ontario. Further, if a holding company were to abrogate its responsibility toward the utility in this regard, the Board may punish the utility shareholders through its determination of capitalization ratios and by awarding a lower rate of return on common equity. The Joint Undertaking regarding dividend payout by the utility will promote Union Gas's continued financial integrity and will also ensure that the ratepayers are not forced to provide funds to cover losses of unregulated affiliated businesses.

Therefore, given a number of variables such as the financial strength of Unicorp, an independent Union Gas board of directors, the Joint Undertakings and strong on-going regulation, it is unlikely that these five concerns will materialize, and thus the acquisition will improve the utility's ability to attract capital and should accordingly be approved by the Board.

In his testimony regarding Phase II matters, Dr. Cicchetti emphasized that a pre-approval hearing designed to examine ex post facto a transfer of control is neither economically efficient nor protective of the public interest. Both interests are better served by relying on an established code of behaviour with rules designed to regulate affiliated interest transactions between a utility and its holding company. This alternative model would remove the ad hoc and uncertain nature of the current approach and would also ensure that the Board is not put in the position of becoming a participant in the sales contract.

The "public interest" includes two concerns; economic efficiency and the cost of capital. The economic efficiency concerns relate to our market-oriented economy which requires a free exchange of ownership and control of capital assets. Economic efficiency maximizes the return on invested capital by rewarding good performance through an increase in share value and an accompanying realization of capital gains.

This incentive attracts investment capital which will ensure that the corporation performs efficiently. Conversely, restrictions on the free transfer of assets results in economic inefficiency because it insulates the utility from market forces.

The cost of capital concerns relate to the general public concern which requires that the economic strength of the utility be protected thereby ensuring that it continues to provide service to its customers at a reasonable cost. Barriers to a transfer of ownership reduce the liquidity of an investment and thereby adversely affects the cost of capital to the utility which in turn impacts upon the price consumers pay for natural gas.

The regulators should not to be concerned with the change of ownership per se, but rather with the need to protect the utility from transactions arising from its association with a diversified corporate structure or a holding company. Essentially, this issue boils down to two regulatory concerns. First, ensuring that utility assets are not stripped for non-utility purposes and second, ensuring that the utility's assets are not used to secure investments in non-utility activities, which would thereby increase the utility's risk.

These concerns are best protected through an enactment of rules. Dr. Cicchetti stated that while "there is no substitute for strong on-going regulation, there exists a recognized need for new rules to address current market developments and to deal with concerns arising from diversification and holding companies."

The present legislative situation is an uncertain one. Section 26(2) does not provide for regulatory treatment of direct acquisitions of a gas utility. Undertakings, because they are given on a case-by-case basis, do not establish a set of firm standards. There are no general rules which govern the relationship between the parent and its subsidiaries once the acquisition is complete.

Further, Section 26 does not deal with the acquisitions of shares of a holding company controlling a gas utility. Accordingly, the adoption of explicit language was recommended for the purpose of providing direction to potential investors in utilities, to utilities themselves, and to their affiliated interests.

The proposed code of behaviour (the "Affiliated Interest Rules") would take the form of a series of prohibitions applicable to all natural gas distribution utilities in Ontario, and to their affiliated companies and persons. However, this code would not apply to the utility's holding company. The rules cover nine areas of concern; indebtedness, loans and investments by the utility, loans to directors and management, regulated activities, acquisition premium, cost of reorganization contracts and transactions with affiliated entities, and capital structure.

Certain matters should not form part of the general prohibitions and are more appropriately dealt with through the process of on-going regulation. Matters falling into this category include the allocation of management costs, reorganization costs; dividend restrictions, retained earnings restrictions; capital structure and other related matters.

Certain issues need not be directly addressed by the Board. Such matters include the definition of control, composition of the board of directors of the utility with the single qualification that the utility board must consist of a majority of independent directors, head office location, and a change in control. This latter concern was qualified to the extent that the affiliated interest rules are put into effect and a complete notice of acquisition is filed with the Ontario Energy Board.

Therefore, the proposed legislation would contain four essential considerations. First, the rules would not operate as a "barrier" to either a direct or indirect change in ownership or control of the utility except in special circumstances. Such special circumstances could include political concerns such as the degree of concentration within a particular industry. Second, a code of behaviour concerning the control and treatment of the utility by the parent should be introduced. Third, the prohibitions outlined in the rules should be appealable to the Ontario Energy Board. Fourth, the rules should be flexible and ongoing regulation should provide for exceptions to those rules for special circumstances.

The "stand alone" principle underscores all the Affiliated Interest Rules. This principle requires that the utility be operated and regulated as a separate economic entity. Accordingly, the holding company owning or controlling the utility maintains a debt and equity or capital structure which is separate from that of the utility. Similarly, the Board regulates the utility on the basis of a separate capital structure and with regard to an independent evaluation of financial and business risks and returns. Accordingly, one of the rules provides that the utility may not invest in nor acquire an economic interest in non-related activities or related competitive activities. However, this does not imply that the utility should be prohibited from diversifying. With respect to the matter of indebtedness, the rules require that utility assets and earnings are not used to secure the debt, equity or investments of non-subsidiary or affiliated companies or persons.

An independent board of directors, which was defined as being a board composed of a majority of independent members, is crucial in alleviating regulatory concerns such as these relating to capital structures, dividend payouts, retained earnings, investments and other similar problems.

The matter of enforcement forms an integral part of these rules. Three examples of enforcement used by regulatory authorities in the state of Wisconsin are the following; fines, cease and desist order, and denial of unreasonable expenditure inclusions in the utility's rate base.

Dr. Cicchetti asked to consider if he would add to his affiliated interest rules a requirement that a portion of the utility earnings be retained in the event that the retained earnings of the utility are insufficient to maintain its equity at a level enabling the utility to continue its business operations. In the alternative it was suggested that the Ontario Energy Board be granted the power to compel the holding company to provide additional equity capital to the utility on terms that are at least as favourable as it would have obtained in the market for the purpose of maintaining the utility equity at an appropriate level.

Dr. Cicchetti disagreed with this proposal on two grounds. First, the maintenance of a reasonable capital structure through a control of retained earnings and dividend payouts is a responsibility of on-going regulation. Second, requiring a holding company to become a provider of equity of last resort runs against the grain of free-market economic relations requiring that the shareholder remain anonymous and that his liability be limited. However, he did agree that the option of allowing the utility to go to the equity market directly may be reasonable in circumstances where the holding company refused to provide funds necessary to the utility for capital expansion and thereby brought itself into conflict with its duty to serve.

It was noted that under the Securities of Utilities Act of Wisconsin which is administered by the Public Service Commission, the regulatory authority is empowered to directly regulate a utility's dividend policy. Chapter 184 of that Act provides that a utility may not issue securities without the authorization of the regulator authority. Clause 184.05 sets out the factors which should be considered by the regulatory agency in giving its approval. They include, the character of the proposed securities, the purposes for which they are to be issued and the terms upon which they are to be issued. The terms of issuance to include a detailed description and statement of value of the property or services which will be received as consideration.

Further, Clause 184.11 provides that wherever the commission finds the financial condition of the utility to be impaired it has the power to order an investigation, hold a hearing, and ultimately issue an order directing the utility to cease paying dividends on common stock until such time as the impairment to its financial condition is repaired. It was argued that this provision would help prevent management from paying out a dividend in excess of what is reasonably required to secure the utility's financial stability. In response Dr. Cicchetti said that the existence of responsible management ensures that this scenario would never occur. However, he agreed that if such events did transpire the customers of the utility would suffer.

Mr. K. J. Slater

Mr. K. J. Slater, a Senior Vice President of Energy Management Associates, Inc. of Atlanta, Georgia, was retained by Unicorp. He testified on issues relating to a change of control of a utility.

The performance of a utility directly results from the way in which it is managed and regulated. The role of an owner is twofold. First, to provide capital and second, to put the utility management in place. Thus, the type of ownership of a utility does not directly affect its performance. However, because an owner can determine the way in which a utility is managed the type of ownership or control may affect the utility's performance. The most beneficial structure of control is one which allows a small cohesive and interested group of people to substantially influence the direction and therefore the quality of management. The owners need not necessarily have utility experience, as long as the owners have a sound business background.

Mr. J. J. Oliver

Mr. Oliver, a Senior Vice President of Nesbitt Thomson Bongard Inc., was retained and testified on behalf of Unicorp. He addressed the following issues: the cost of capital to Union Gas, the strength of the parent theory, the prior-approval process, utility diversification, the divident payout rule and the preferred share interlock.

Mr. Oliver indicated that Unicorp's acquisition of control of Union Enterprises will neither materially impact upon Union Gas' on-going ability to raise capital, nor effect its overall cost of capital or creditworthiness. This is primarily due to the fact that Union Gas will continue to raise capital in the external markets in its own name. The market considers three factors to impact upon a change of ownership or control of a utility; a sound regulatory environment, undertakings, and to a much lesser extent the financial condition and managerial approach of the principal shareholder. In the present case the Joint Undertakings to the Lieutenant Governor in Council are a "significant source of comfort" to the investment community.

The strength or weakness of the parent or grandparent will not adversely influence the credit rating agencies, analysts or investors. In fact, a slight advantage may arise from being controlled by a strong parent if for example, that parent is willing to participate in the dividend reinvestment program and thereby inject additional capital into the utility.

In the event that Union Gas requires additional equity to undertake capital expansion, such funds could easily be raised from three alternative sources; additional direct and or indirect purchases of common equity in Union Gas by Unicorp, and direct access by Union Gas to the capital markets.

A prior approval requirement for a transfer of ownership or control would increase the cost of capital to the utility. While the market understands public policy objectives, Mr. Oliver said that

> ... the more specific the guidelines the more readily the market could accept them ... [however] to the extent one creates barriers to entry and creates delays or uncertainties, then clearly that adds to the cost, because it potentially removes certain legitimate inquirers and it dissuades others who don't want to take on the uncertainty.

It was asked whether a rule requiring that a utility not invest in or acquire an economic interest in a non-related activity without the consent of the Board, would impact adversely on the cost of capital to that utility. In response Mr. Oliver indicated that such a rule would not affect the cost of capital. However, if a utility invests in non-utility assets then the cost of common equity would depend upon the profitability and significance of the non-regulated activities.

With respect to the dividend payout rule contained in Chapter 184 of the Wisconsin PUC Act, if such a rule were to be enacted in Ontario it would not increase the cost of capital to the utilities, if this policy were implemented in a liberal manner.

It was contended that the $104,000,000 preferred share obligation from Union Shield Resources owed to Union Gas would only be protected pursuant to the undertakings if Union Enterprises remains financially sound. Accordingly, it was asked whether the introduction of a rule requiring that Union Enterprises and Union Shield Resources not merge nor amalgamate, nor materially sell their assets nor go to the markets for substantial capital would impact adversely upon the cost of capital to Union Gas. Mr. Oliver indicated that while the cost of capital to Union Gas would not be increased, the rule will adversely impact upon Union Enterprises' ability to provide equity to Union Gas.

Dr. R. W. Waters

Dr. Waters, a professor of Economics and Finance at the University of Toronto was retained and testified on behalf of Unicorp. He addressed the following matters: the utility's duty to serve, the impact of the acquisition upon the duty to serve, and the desirability of additional rules and regulation.

Dr. Waters indicated that as a public utility Union Gas operates in the public interest and therefore has privileges and corresponding obligations. The obligations arise from a duty to serve which results from the privilege of a franchise licensing the utility as the sole distributor of gas within its service area. As a result of its obligation to serve the utility's continued ability to undertake necessary expansion is of critical importance and requires that the utility have continued access to the capital markets on reasonable terms. Accordingly, the public interest requires that the financial integrity of Union Gas be maintained. Dr. Waters concluded that the Unicorp acquisition will not adversely impact upon the financial integrity of Union Gas because the utility is regulated on a "stand alone" basis and because the Joint Undertakings provide adequate assurances regarding the utility's future financial integrity.

Regarding the issue of whether new rules should be introduced, Dr. Waters indicated that if a regulatory environment does not keep pace with the practice in the corporate world new prohibitions may be required to ensure that the public interest continues to be protected. However, new rules should not be directed towards regulating the transfer of ownership or control but towards establishing a code of behaviour governing the relationship an owner is to have with the utility. The areas which should be controlled are disposition of assets and utility financing. Nevertheless, there is a danger of constraining normal economic activity by introducing a proliferation of regulations intended to cover unusual circumstances.

Dr. W. J. Baumol

Dr. Baumol a professor of Economics at Princeton and New York Universities was retained as an expert witness by Unicorp Canada. He testified on the following matters: the Joint Undertakings, the market economy and regulation, takeovers, concentration of ownership, the regulatory objective of the Board, and the desirability of rules.

Dr. Baumol indicated that given the Joint Undertakings and the existing regulatory environment in Ontario the indirect acquisition of Union Gas by Unicorp does not pose a threat to the public interest and he accordingly recommended that the Board approve this acquisition.

In a capitalist society, market forces provide competitive incentives which promote greater economic efficiency. In short, the presence of competitors compels efficiency. Since utilities enjoy a franchise monopoly they do not face head-on competition and accordingly incentives for efficiency originate from the free market transfer of ownership of utility shares through a takeover.

Takeovers were also perceived to provide necessary economic efficiency incentives to the management of a regulated firm. The combination of diversified ownership, regulation and an absence of head-on competition serves to entrench management inefficiency, and only a takeover can eliminate it. A freely functioning market for the transfer of corporate ownership and control coupled with the realization that shareholders can tender their shares to an acquirer possessing the power to change an entrenched management or management policy acts as a valuable check on management. For this reason management seeks to prevent takeovers.

Concentration of ownership is essentially on anti-trust matter which is not at issue in this case. Concentration was defined as being related to two issues. First, the acquisition of ownership and second, the share of assets in an industry. The Ontario Energy Board should be concerned about the concentration of an industry rather than of ownership. It is concentration within an industry which is detrimental to the public interest and economic efficiency because it reduces competition. In the context of concentration of ownership the issues are different. In this context the focus is upon preventing economic exploitation of the utility through evasion of regulatory restraints. However, a concentration of ownership is beneficial in merging ownership with control which has the effect of constraining management to act efficiently.

The concepts "ownership" and "control" were distinguished. The term "control" was defined to technically comprise the ownership of fifty percent or more of a company's outstanding voting shares. However, effective control is often obtained by less than that amount where the remaining shares are widely dispersed. Control in this wider context results from the following circumstances. Direct control occurs when an individual or group control a significant percentage (for example 20 percent) of voting shares, and act jointly in the exercise of control. Indirect control occurs under the same circumstances but is exercised through a holding company. Accordingly Dr. Baumol indicated that, "there is no simple formula for a numerical threshold, and if any specific number is correct in the instance, it is likely to be wrong in another".

The regulatory objective of the Ontario Energy Board requires that a franchised utility be regulated in a manner which will best serve the interests of the consuming public. The public interest requires a maximization of benefits to consumers of natural gas as well as an adequate return to shareholders. This later requirement is particularly important to the utility's ability to attract investment capital required for the expansion of its facilities.

When a utility is controlled by a holding company, in common with unregulated corporations, a concern arises that the unregulated corporations may benefit from this common ownership to the detriment of the utility. Accordingly, he recommended that instead of inhibiting the transfer of ownership through a pre-acquisition approval hearing, the Board should adopt rules governing economic relationships between regulated and unregulated affiliated enterprises, because only rules will prevent future problems. Such rules would regulate economic relationships between such entities and would relate to purely financial transactions including: dividend policy, exchanges and sales.

These rules would not preclude a utility from diversifying into non-utility but related enterprises for two reason. First, affiliated enterprises create economies of scale which benefit society in general. Second, the utility benefits from the unrelated affiliations because such enterprises add to the utility's financial integrity by reducing some of the risks to which it is subject.

Mr. F. M. Edgell

Mr. Edgell, the Senior Vice President of Utility Operations for Union Gas and a Vice-President of Union Enterprises testified on behalf of Union Gas. He provided an overview of operations and indicated the importance of capital expenditures in maintaining the quality of service to a utility's customers.

The evidence presented showed that the company's five year forecast of capital requirements, as expressed in millions, will be as follows: for 1985 $78,906; for 1986 $108,000; for 1987 $127,640; for 1988 $179,653; and for 1989 $108,099.

Mr. M. J. O'Neill

Mr. O'Neill, the Treasurer of Union Gas and Union Enterprises appeared on behalf of Union Gas. Testimony given by Mr. O'Neill covered two areas of concern; the preferred share interlock, and the Burns Foods transaction.

As a result of the reorganization, Union Gas sold the non-utility assets to Union Shield Resources for $200,000,000. Part of the consideration received by Union Gas included a preferred share issue from Union Shield Resources for $104,000,000. Under the terms of the reorganization agreement, Union Shield Resources is obligated to pay an annual dividend of $9,000,000 to Union Gas to cover the $104,000,000 obligation. Union Gas will in turn dividend the $9,000,000 up to Union Enterprises as a special dividend over and above the $27,000,000 annual dividend. The preferred shares are redeemable within 10 years. A sinking plan or any other plan for partial redemption has not been established to support the $104,000.000 obligation from Union Shield Resources to Union Gas.

Union Shield Resources expects to pay for the interlock from income derived from non-utility investments. Such income would include an annual dividend for $1,200,000 from NUMAC to Union Shield Resources and a cash flow of $20,000,000 from PreCambrian Resources. In addition, PreCambrian Resources has access to a $50,000,000 line of credit. Capital expenditures are not planned for either PreCambrian or NUMAC and accordingly there will not be a drain on the dividends received by Union Shield Resources.

It was questioned whether the Burns Foods acquisition is self-financing, given the company's expected annual cash flow of $20,000,000 and its projected capital expenditure program of $13,000,000 per year over the next five years. Union Enterprises' obligation to pay $10,000,000 annual dividend to Burns Foods will be sufficient to cover cash shortfalls which may arise in the early years. However, Union Enterprises and Burns Foods both have sufficient lines of credit.

The fact that Unicorp as a parent company exhibits weaker financial ratios than Union Gas or Union Enterprises, may influence the ability of Union Gas to raise capital at comparable rates. However, it was noted that Mr. O'Neill's financial ratios are based upon three assumptions which if altered would indicate that Unicorp is a stronger parent than the ratio have represented it to be. First, the ratios were compiled without the benefit of Unicorp's most up to date financial projections. Second, minority interests are not treated consistently in that they are included in the preference shares held by Union Enterprises while excluded from common equity. Third, the calculations assume that Burns Foods, Union Enterprises, and Unicorp pay taxes at the normal corporate rate of 50 percent. In fact, Unicorp does not pay taxes and Burns Foods does so at a rate lower than 50 percent. Also, to the extent that the market views Union Gas as raising capital on a stand alone basis, the financial ratios become completely irrelevant.

Mr. T. E. Kierans

Mr. Kierans, the President of McLeod Young Weir Limited, was retained as an expert witness by Union Gas. He testified on the following matters: the cost of capital, the reorganization of Union Enterprises, the Settlement Agreement and the Joint Undertakings, the preferred share interlock, the advisability of additional rules and regulation.

Mr. Kierans testified that the reorganization of Union Gas did not affect the credit rating of the utility. The two leading Canadian rating services, Dominion Bond Rating Service and Canadian Bond Rating Service continued to rate the securities of Union Gas highly. In fact, the creation of a pure utility was regarded as having reduced the risks associated with non-utility investments and was therefore perceived positively. Further, the Undertakings given to the Lieutenant Governor in Council, intended to ensure the continued strength of Union Gas, and to protect the dividend and redemption obligations of Union Shield Resources to Union Gas, were important in appeasing the concerns of the financial community.

The Settlement Agreement and the Joint Undertakings have impacted positively upon the market's perception of Union Gas and will accordingly permit the utility to raise common equity capital on reasonable terms. Specifically there were four positive influences. First, a positive regulatory environment without additional controls and procedures. Second, assurances that the financial integrity of Union Gas will be retained, including the assurance that Union Gas will have access to internal sources of capital on terms as reasonable as it may obtain externally. Third, capital expenditures will be initiated and implemented thereby ensuring a high standard of service on an ongoing basis within the franchise area. Fourth, existing management will be retained.

The preferred share interlock will not be adversely affected by the Unicorp acquisition for two reasons. First, the undertakings given by Union Enterprises at the time of reorganization ensure that Union Shield Resources will be capable of meeting annual dividends and future redemption obligations. Unicorp has adopted this undertaking. Second, the Joint Undertakings further provide for an independent board of directors at the level of Union Gas and Union Enterprises and for a commitment to maintain the preferred share obligation.

The fact Union Enterprises does not have an income flow of its own is not relevant to its financial strength or to its ability to fulfill this dividend commitment because Enterprises consists of a very valuable accumulation of assets.

While takeovers help to remove entrenched management and thereby promote economic efficiency there must be sufficient regulatory policies in place to ensure that the public interest is protected. This goal is accomplished through the prohibition of adverse dealing practices and combinations, and not through the prevention of takeovers. The public interest requires the Ontario Energy Board to examine two interests. First, that of the shareholders to ensure they are receiving the best possible consideration for the value of the assets. Second, that of the consumers to ensure that the service will continue to be provided at a reasonable cost.

Because the utility has a duty to serve, the Ontario Energy Board should ensure that the utility's management is not accumulating large pools of assets to build a larger company by shifting the burden of that cost to the consumer. It does this by double-leveraging the company in order to enhance capital extraction at the risk of increasing the cost of capital to finance the rate base. Action on behalf of the Ontario Energy Board in this regard would not constitute on unwarranted interference with managerial discretion. This type of example is an illustration of "where the rubber meets the road between management's discretion and the Board's legitimate concern as to whether something is economical or appropriate."

Undertakings are necessary to protect the financial integrity of the utility. As long as the required undertakings are provided the Board need not inquire into the personality of the entity acquiring control. The Board does not have the authority to demand undertakings, but it posses the ongoing power to regulate the utility and thereby punish. Therefore, it does not require a formal enforcement mechanism. Further, an individual making a major investment is prepared to work within the existing regulatory environment. If, however, an investor does not voluntarily negotiate the undertakings with either the Board or the Ministry of Energy then the purchaser should be given a "cooling off" period in order to negotiate such undertakings.

The undertakings need not necessarily be enshrined into rules of law. This approach is self defeating because strict rules are inflexible and therefore incapable of foreseeing future occurrences. Mr. Kierans rejected Dr. Cicchetti's proposition that rules reduce uncertainty in the market place and therefore impact positively upon the cost of capital. He said that

> "the best security that any investor has got in this system right now is the embedded series of decisions, historic decisions, that indicate what will happen in the future".

By establishing rules the Board will be establishing a basis for a new set of decisions. This process is very upsetting to investors and may increase the cost of capital to the utility.

Mr. Kierans was particularly against a rule intended to control a utility's dividend policy. The dividend payout policy of any company is within the authority of the board of directors of a company who act upon recommendations from management. Regarding a dividend policy having a "worst case" scenario provision he said that,

> to constrain within a market economy on the basis of the unsupported assessment of the possibility of something developing is a very serious intrusion on the correctly presumed abilities and good faith of management and the Board of Directors.

While the introduction of a formalized monitoring process will not necessarily increase the cost of capital it should not be introduced for the following reasons. First, a latent code of behaviour exists within this jurisdiction and is understood by the investment community. Second, an investor is unlikely to "toy" with the regulatory environment because this is the single largest determinant of the quality of a utility investment. Third, existing close supervision of a utility's cost of service and operations constitutes an assurance that the interests of the consumer will be protected. Also, the Board may call in the utility on its own motion and subject it to examination. Fourth, additional monitoring may impact on the discretionary judgment of management and thereby distract it from efficiently managing the utility. Mr. Kierans said, "the process is working quite well without the importation of a new set and layer of regulation."

Dr. G. R. Hall

Dr. Hall, the Vice President of Charles River Associates of Boston, Massachusettes, and a former Commissioner of the U.S. Federal Energy Regulatory Commission was retained as an expert witness by Union Gas. He addressed the following matters: the role of regulation, the advantages and disadvantages of a holding company structure, the utility's obligation to serve, and the advisability of rules and additional regulation.

He testified that a utility is granted an exclusive franchise to serve within a geographic region, which creates a monopoly market free from competition. Monopoly results from the fact that in certain industries a simple firm can supply the market at a lower cost of production than can a number of competing firms serving the same market. This process has been referred to as an "economy of scale and scope". However, due to the fact that the service is considered essential to a certain standard of living the government intervenes through regulation to control both prices and entry into such markets.

Dr. Hall described a regulated monopoly as constituting a social contract between the utility and the regulators. Under the social contract the utility possess a commitment or duty to serve present and future customers at just and reasonable rates. This obligation requires the utility owner to forego "windfall" profits but also requires that the cost of service to the customers includes a fair return to the shareholders of the utility. The regulator possess a corresponding obligation to grant a rate of return that will permit the utility a fair chance to earn a compensating return on the investment.

Ownership of a utility by a diversified holding company is desirable for two reasons. First, the holding company structure assists the regulator in distinguishing regulated from nonregulated activities. Second, the holding company structure permits financing by subsidiaries or by the holding company and thereby increases avenues for access to capital.

Four disadvantages militate against the holding company structure. First, inter-corporate dealings that are not at arm's-length will result in higher prices or a higher than market-value allocation of cost for goods and services to the utility. Second, the customers of the utility may cross-subsidize the unregulated corporate affiliates. Third, the ability of the utility to access capital on reasonable terms may be adversely affected by the wrong type of capital structure. Fourth, the misuse of the holding company structure may result in a conflict of interest which can adversely affect the ability of the utility to carry out its duty to serve. Accordingly, the Board should ensure that the acquisition of Union Gas does not adversely affect the ability of the utility to raise capital on favourable terms. This requires the regulators to assure that those managing or controlling the holding company have, first, adequate resources, and second, that they do not have a conflict of interest which may affect their ability to ensure that the utility adheres to its obligation to serve.

While in theory the "milking" of a utility can be controlled, in practice this may not be possible because it may involve the regulators in the "micromanagement" of the utility which is bad public policy, unsupportive of consumers interests. A more appropriate approach would ensure that the utility first, has access to capital required for expansion and, second, is adequately protected against conflicts of interest with the holding company.

The utility's obligations to serve necessarily require that the utility undertake major investment programs of capital expansion. Such programs will require the utility to put funds into capital expansion despite the existence of higher rate of return from other investments.

The Joint Undertakings provide Union Gas with adequate financial protection, because they ensure access to required capital, they guarantee sufficient independence of action regarding external financing, access to internal financing on reasonable terms, an independent Board of Directors, and that the utility will not be responsible for the financing and debt of affiliates. Accordingly, the Board should approve the present acquisition on the grounds that the undertakings provide adequate protection to the Ontario gas consumer.

Due to the fact that the public interest requires that the Ontario Energy Board closely examine the impact of a proposed acquisition upon the utility's ability to meet its obligation to serve and its ability to maintain itself in sound financial condition, the pre-approval review process pursuant to Section 26(2) of the Act should be extended to apply to a holding company acquiring over 20 percent of a utility.

Dr. Hall rejected Dr. Cicchetti's proposal to introduce a formal set of rules for four reasons. First, rules currently exist and are being followed. Second, even if rules are introduced a change of ownership should undergo governmental review because the public will express some concern in this regard. Third, a review will be required to ensure there has been compliance with the rules. Fourth, each acquisition will be unique in nature and extenuating circumstances will require the investors to seek waivers. The public interest is best protected by the regulators through a series of concerns set out as conditions which must be fulfilled and, by determining compliance with such rules through a preliminary review conducted on a case by case basis.

Regarding the issue of diversification, Dr. Hall preferred that it take place through the holding company rather than through the utility. However, he did not disapprove of utility diversification per se as long as the non-utility activities are restricted to subsidiaries of the utility, and the utility is adequate protected against non-arm's length transactions and cross-subsidization of non-utility subsidiaries.

The Ontario Energy Board possess the power to indirectly examine dividend policy through an investigation and approval of the utility's financial integrity. Therefore, it should not attempt to directly control the dividend policy of a utility because this responsibility is the particular concern of management.

Mr. W. Darcy McKeough

Mr. McKeough, the Chairman of Union Gas and Union Enterprises appeared on behalf of Union Gas. He testified on the following matters: the entrenchment of management, the reorganization of Union Enterprises, the utility's duty to serve, Section 26 (2) and the advisability of additional regulation, the undertakings, the common share float and the acquisition of Burns Foods.

Mr. McKeough testified that management inefficiency is not entrenched by the absence of a takeover treat. In fact the takeover process had a short term negative impact on senior management morale. Management efficiency is encouraged by the vigilance and interest expressed by both the utility's board of directors and the regulating authority.

Section 26(2) is intended to provide a mechanism for the review of concentration of ownership within a gas utility. As such, when this control results indirectly through a holding company it remains within the spirit of this provision. Accordingly, the Ontario Energy Board should review an acquisition of indirect control to determine whether it is in fact in the public interest. Because Section 26(2) governs holding companies only in spirit it should be extended and made to apply as far up the corporate chain as is necessary.

Ownership of a public utility imposes a trust obligation on the directors and a duty to serve upon the management. The utility must be prepared to undertake capital expansion under which the pay-back period is uncertain or deferred. Accordingly, the strength and initiative of the parent to undertake such capital expansion should be a matter of concern within the context of a pre-acquisition review, and provides the reason for examining the background and credentials of those acquiring control of a utility.

Union Gas will require future capital expenditures to maintain and expand the present storage, transportation and distribution system. An estimated total between $78,000,000 to $179,000,000 will be required over the next five years. The expenditures are essential to Union Gas' ability to service its franchised area.

Due to the size of the capital expenditures Union Gas must have the ability to raise large sums of capital. Its ability to do so will depend upon the market's perception of the strength and stability of Union Gas and of its parent Union Enterprises. Therefore, the financial strength of Unicorp is of importance in determining the market's perception of Union Gas' financial stability for two reasons. First, if Unicorp encounters difficulties in meeting its preference share dividend requirements it may resort to additional debt financing. Second, if Unicorp finances by increasing the leverage and risk associated with the debentures and preferred shares of Union Gas then the utility's capital expenditure programs may not be undertaken. However, the joint undertakings adequately address these concerns.

The undertakings are binding and enforceable by the regulators or by the government through retroactive legislation. The Ontario Energy Board may wish to enumerate the undertakings into a set of policies but should not enshrine them in the form of legislation or regulations because rules are inflexible. Also, rules will require exceptions which will ultimately result in uncertainty, because legislation invites courtroom litigation.

In particular the Ontario Energy Board should not enact rules governing dividend policy because it already possess the power to regulate the utility's dividend payout policy indirectly. In fact, the undertaking placing a three year restriction on the payment of dividends has had a "dampening" effect in the market. Likewise, the Ontario Energy Board should not pass a rule governing the issuance of securities because such regulation interferes with management discretion and may restrict the utility's access to "windows" in the market for borrowing.

A large concentration of Union Gas shareholders reside within the franchise area. The majority of such small shareholders would prefer the utility to remain widely held as opposed to being concentrated in the hands of a single owner.

However, a common equity float is desirable for a utility for two reasons. First, it ensures public participation in the utility's ownership. Second, it facilitates the OEB's determination of ratc of return because it presents the Board with evidence of the price at which the stock is trading. Mr.McKeough said that this is a long-term goal for Union Gas.

Regarding the matter of diversification Mr. McKeough indicated that the purpose of reorganizing Union Gas was to separate the utility operations from the non-utility assets for the purpose of simplifying utility regulation and to facilitate expansion into non-regulated areas. Also, Union Enterprises could shelter taxable expenses which would not have been allowed by the Board as part of the rate base of Union Gas. Nevertheless, Mr. McKeough maintained that a utility must be permitted to expand into non-utility activities of a restricted financial nature. Such additional sources of income would benefit the utility's customers. Due to their limited nature such activities would not complicate the regulatory treatment of the utility.

Burns Foods was purchased by Union Enterprises because it is a low-risk investment with a high positive cash flow which will enhance the ability of Union Enterprises to attract capital on favourable terms. It is also hoped that it will in the future result in an infusion of common equity capital through the conversion of the preferred stock. Further, the shareholders of Burns Foods agreed to accept preferred shares rather than cash as consideration for the sale.

This acquisition does not unduly concentrate the voting control of Union Enterprises. The voting shares issued to Burns Foods represent less than 20 percent of the total number of voting shares outstanding in Union Enterprises and therefore falls within the purview of Section 26(2) of the Act.

The Board of Directors of Union Enterprises had approved the acquisition, but Mr. Eyton and Mr. Dunford, who were absent, subsequently dissented.

Mr. R. Martin

Mr. Martin, the President and Chief Executive Officer of The Consumers' Gas Company appeared on behalf of Consumers Gas and testified on the following Phase II issues: The public interest, the holding company structure, the undertakings and financial integrity of a utility, the desirability of additional formal rules and the common share float.

Mr. Martin accepted the existence of Section 26(2) as a fact but was concerned about any restrictions upon the free transfer of the shares of either a utility or of its parent. The public interest is best protected by provisions other than those found in Section 26 of the OEB Act. Such provisions include those found in the Securities Act, the Combines Investigation Act, and the common law. Competition from other suppliers of energy also acts as a control on the utility.

The ownership of the utility's shares does not effect its obligation to serve. This obligation is implied from its franchise, and if its owner fails to fulfill the utility's obligations and duties the franchise may be reviewed and/or revoked. Further, the experience of the

Consumers' Gas company has indicated that a utility can benefit from the presence of a strong parent company such as Hiram Walker. Specifically, the strength of the present has strengthened the financial integrity of Consumers Gas by improving its debt and preferred share ratings. In addition, because the cost of capital is directly related to Consumers' Gas rates ownership by a holding company has not caused utility rates to increase.

Provided the financial integrity of the utility is protected, diversification within a utility should not be restricted. Management must be permitted to maximize the efficient utilization of assets because utilities within Ontario are entering a mature cycle of market saturation. Continued growth is essential for the purposes of attracting managerial talent and maximizing profits.

The undertakings need not be enshrined into rules of law for the following reasons. First, such undertakings are taken very seriously by the regulated industry. Second, the OEB expressly reviews and rules upon matters relating to a utility's financial integrity as a regular part of the rate hearing process. Further, a rule governing the issuance of securities will impair the company's ability to finance its capital requirements in the most flexible manner. Delay resulting from a pre-approval would restrict the utility's access to market "windows".

The public float was created pursuant to an undertaking given at the time Consumers' Gas purchased Hiram Walker. As part of the float common shares were issued at a cost of $14.00 per share plus one warrant. As of April 19, 1985, that value has substantially appreciated to a total share and warrant value of $30.00.

Mr. Martin favoured the existence of a common float because it provides three major benefits. First, it is an additional source of common equity to finance capital expansion. Second, because it is an additional finance avenue it provides greater flexibility. Third, it provides a proxy to the OEB for market efficiency. In addition, the common float renders management responsible to minority shareholders and thereby provides encouragement to increase profits.

Mr. R. Graham

Mr. Graham the President and Chief Executive Officer of Inter-City Gas, testified on Phase II matters. He addressed the following issues: the extension of Section 26 (2), and the enforceability of undertakings.

He believed that Section 26(2) was enacted for practical political reasons and that it is not required in practice. This section was intended to cover a concentration of ownership within the industry rather than a concentration of ownership within a particular utility. Therefore, he recommended that Section 26 (2) be revised to clearly deal with cross-ownership between utilities. Under this proposal, a pre-acquisition approval of the Board would be required only where a gas utility purchases over 20 percent of the voting shares of another gas utility. Similar transactions as between holding companies should also be covered through the mechanism of a "reviewable transaction provision". Powers of this nature should be accompanied by appropriate remedies applicable to both utilities and to their parents or grandparents.

The undertakings are enforceable and binding. However, a provision should be added to the OEB

Act which would enable the Supreme Court of Ontario to direct compliance with an undertaking under penalty of a contempt citation for any refusal to comply. Also, undertakings given by a holding company should be made binding on any and all successor corporations.

Mr. H. Andrews

Mr. Andrews the Vice-President of Finance and Regulatory Affairs of Northern Central Gas testified on behalf of the utility. He addressed the following issues: the holding company structure, reorganization, the financial strength of the parent, undertakings, and the desirability of additional formal rules.

Mr. Andrews indicated that despite Inter-City's takeover of Northern and Central Gas the utility continues to be operated independently. Operating decisions are made by the utility's management who are also responsible for preparing its operating and capital budgets. In addition, the timing and type of financing required by the utility have continued to be determined by the Vice-President of Finance of Northern and Central Gas.

Northern and Central is currently undergoing a reorganization the purpose of which is to permit the utility to operate on a "stand alone" basis. This is a positive step for two reasons. First, it will facilitate the regulatory process and second, it will assist the utility in future financing by establishing for it an independent credit rating.

The financial position of a parent company does not affect the credit rating of the utility or its ability to raise independent financing.

However, a strong parent with a credit rating superior to that of the utility may advantage the utility by assisting it to raise capital on a more favourable basis. The parent may also provide financing to the utility on a back-to-back basis. Possibilities such as these provide for greater flexibility in raising capital.

Undertakings are not necessary to protect the public interest which is concerned with the utility's ability to provide reliable service at reasonable rates. A prudent owner with a substantial investment will not behave in a manner which will impair his investment in the utility. If an owner acts in a non-prudent manner, contrary to the behaviour prescribed by the undertakings then the OEB can punish this behaviour by rewarding a reduced return on rate base.

Rules and regulations of the nature advocated by Dr. Cicchetti are not necessary. Such matters are best left to on-going regulation and review in the context of rate hearings. If however, the OEB adopts an additional layer of regulation it should not adopt the following rules. First, loans to affiliates should not require the pre-approval of the Board. Such matters may be examined during the rate hearings. Second, the utility should be capable of expanding, without prior approval, into related activities which promote the sale of gas. Third, the cost of acquiring other small utilities should be allowed in rate base. Fourth, costs of reorganization benefiting the utility should be included in the cost of service. Fifth, a public utility should not be prohibited from making loans to its directors because this is accepted corporate practice.

Dr. W. T. Cannon

Dr. Cannon, an Associate Professor of Finance at Queen's University was called by Ontario Energy Board Counsel to testify on issues relating to Phase I and II matters.

Regarding diversification, he indicated that a "utility-centred corporate organization" should be permitted to employ its accumulated retained earnings to diversify into non-regulated activities provided the regulators impose limits upon dividend payments and the return on capital to shareholders. Accordingly, regulators should be concerned with the manner in which utility diversification occurs and should impose rules or undertakings to ensure that any potential detriment to the utility is minimized.

Five advantages are derived from diversification. First, where diversification takes place in related activities market and operating efficiencies result. Second, beneficial synergies may result from a spreading of overhead expenses. Third, a diversified company may more readily attract talented management. Fourth, it could reduce the cost of common-equity capital to the utility by providing profitable outlets for excess capital. Fifth, it may promote greater cyclical or seasonal stability in earnings and may thus provide improved access to sources of financing on more favourable terms than would otherwise be available to a pure utility.

The major disadvantage of diversification is that it provides a greater opportunity for "milking" the utility through non-arms length transactions and financial arrangements with non-regulated affiliates. Other disadvantages include: attracting management not suited to the long-term conservative operations of a utility, foregoing capital expansion required by the utility in favour of other high-risk high-return activities, and finally, diversification tends to increase the utility's investment risk and its cost of capital.

Several "drawbacks" also exist. Most prominent is the virtual elimination of conservative investment opportunities available to Canadian investors, particularly to "widows and orphans". The demise of low-risk investment opportunities will "effectively truncate this spectrum of opportunities, diminishing the breadth and diversity of the Canadian stock market and depriving many investors, not just widows and orphans, of those stocks exhibiting characteristics ideally suited to their particular risk preferences and income needs. Over time this can cause the market to lose some of its political legitimacy and would negatively impact upon Canadian "pluralistic capitalism".

Dr. Cannon recommended that a utility be permitted to diversify through the holding company structure rather than through subsidiaries of the utility. However, existing investments in what would become prohibited areas should be "grandfathered".

Seven reasons favour diversification through the holding company structure:

i) income and expense flows amongst subsidiaries will not be comingled and the utility will be easier to regulate;
ii) greater financing flexibility will result from dual access to capital;
iii) the utility may be scrutinized by an independent board of directors;
iv) A seperate corporate identity will enhance managerial responsibility;
v) identification and monitoring of affiliated transactions will be facilitated;

vi) financial difficulties experienced by an affiliate are less likely to impact upon the utility's credit rating or impair its ability to attract capital at reasonable terms;

vii) common shares of a utility may become available and traded on the market (where the shares are not 100 percent owned by the holding company).

Economic efficiency advantages derived from unfettered takeovers are reduced in an environment of monopoly and regulation. This is mainly due to two facts. First, management is not encouraged to enhance efficiency because cost savings over the long term will benefit the customers. Second, utility share prices do not fully reflect management inefficiencies. In Ontario this theory does not have practical application for the future because the three major utilities have already been taken over.

In the absence of rules or undertakings the strength or weakness of a parent company or grandparent company will negatively impact upon the cost of capital to the utility. The nature of the parent if it is for example, "expansion-minded" or aggressive may jeopardize the utility's access to certain segments of the capital market. The parent's attitude and intentions may also influence the effectiveness of regulation, and thereby impair the utility's ability to fulfill its obligation to serve under the social contract.

A weak parent may attempt to extract resources or other undue benefits from the utility and thereby diminish the utility's financial strength and credit-worthiness which in the long run, will impact upon the utility's cost of service. Possible detriments could include excessive dividend payments, intercorporate loans and/or guarantees of indebtedness, sale of utility assets for the benefit of the parent, and non arms-length purchases from the parent.

Although it is financially fully extended, Unicorp currently enjoys a strong financial position. Further, the Joint Undertakings currently in place will sufficiently protect the financial integrity of the utility.

Because the nature, intentions and financial condition of the parent impact upon the utility, there should be some "public input" into the arrangements which are to govern the utility and its controlling shareholder. This public input should take the form of legislation which establishes generally applicable rules. Such rules should be of a nature which would required only exceptional intervention by the Ontario Energy Board.

Rules would provide two advantages; equality of treatment, and certainty. Also the rules must be broadly drafted and administered in a flexible manner to ensure equitable treatment on a case by case basis.

If a set of rules is put into place and the Board monitors compliance through the rate hearing process then a "pre-event" hearing process will constitute an unnecessary impediment to legitimate takeovers. However, a "post-event" hearing should be held to provide the Board with an opportunity to effect remedies where the new owner is found to be incapable or unwilling to "live up" to the required rules.

Dr. Cannon recommended acceptance of Dr. Cicchetti's affiliated interest rules and proposed that they be extended to include the following six rules.

i) The utility should be operated on a fully "stand-alone basis" with a separate capital structure and an independent board of directors.

ii) Rate base assets should not be sold without the approval of the Ontario Energy Board.

iii) The OEB should approve all share repurchases and all issues of a new class or series of debt or equity. This provision should extend to the utility's parent where the utility has guaranteed the indebtedness or has a loan with or owns securities of, its parent or of an affiliate.

iv) The OEB should have the power to suspend dividend payments where the financial integrity or equity base of the utility is being threatened.

v) Utilities whether or not wholly owned by a single parent, should be required to publish and publicly circulate their annual audited financial statements.

vi) A utility should be required to have a minimum of 20 percent of voting control distributed within the Canadian investing public.

It was noted that the dividend veto rule should be used only in exceptional circumstances. It is not intended to control the utility's dividend payments or its payout ratios. Rather, it will enable regulators to regulate better the level and adequacy of the utility's equity capital base in order to ensure that its financial integrity is not being threatened.

Dr. Cannon listed ten benefits associated with having a 20 percent common float.

i) The board of directors would be responsible to a wider ranger of shareholders.

ii) Minority shareholders would have the opportunity and incentive to monitor the activities of management and of the controlling shareholder and be in a better position to take corrective action.

iii) (i) and (ii) would provide an additional layer of protection to preferred shareholders and unsecured bondholders.

iv) It would establish a share price and performance "track record" for the utility's shares and a selling price for the shares where the controlling shareholder sells his interests.

v) It would promote managerial efficiency through the implementation of incentive compensation programs which are directly linked to the market's assessment of the utility's performance.

vi) It would offer the original shareholders a choice between shares of a utility and those of the parent.

vii) It would broaden the range of security investment options available in the Canadian stock market.

viii) It would result in public relations and public confidence benefits.

ix) An independent market valuation would aid the regulators in assessing managerial efficiency and the utility's risk return performance.

x) It would reduce the possibility of political pressures being brought to bear upon regulators to give a low rate of return or equity.

However, Dr. Cannon agreed with Mr. O'Neill that the preferred share inter-lock between Union Gas, Union Enterprises and Union Shield Resources would preclude the implementation of a float. Since this is the case, then the OEB should attempt to rectify the situation, otherwise the cost of equity capital to Union Gas may increase.

Further, Dr. Cannon recommended that Unicorp's accumulated purchases of Union Enterprise's voting shares should be limited to 80 percent until the government has dealt with the OEB's report on Phase II matters or until the passage of two years. Also, the preferred share interlock should be grandfathered but under the condition that the parties undertake to re-design the arrangement so that (a) it is better secured within Union Gas, and (b) it does not impair the ability of Union Gas to issue common equity on its own. In conclusion, the Board should recommend that the Lieutenant Governor in Council approve the transfer of Union Enterprise's shares to Unicorp on the condition that the rules proposed by Dr. Cicchetti and Dr. Cannon are enacted as legislation.

Mr. J. MacNaughton

Mr. MacNaughton a Director of the investment firm Burns Fry Limited, was retained by Union Enterprises under instructions from the Ontario Securities Commission for the purpose of providing an independent valuation of the Burns Foods acquisition. The issue which Burns Fry was asked to resolve was whether Burns Foods was acquired at a "fair price". Mr. MacNaughton appeared at this hearing and gave similar evidence.

In determining whether the purchase price was financially fair to the shareholders of Union Enterprises, Burns Fry valued both Burns Foods and the consideration paid by Union Enterprises.

Six business methodologies were considered and three were retained as being applicable. The primary methodologies considered were: normalized earnings and projected/market value earnings. The discounted cash flow analysis was considered as a secondary or supporting methodology. Based upon this review he concluded that the acquisition of all of the shares of Burns Foods was at a price which is fair to the shareholders of Enterprises given the value of the consideration deliver by Enterprises.

The value of Burns Foods was determined on a consolidated and on an line by line basis. On the basis of the normalized earnings approach for the earnings were as follows; 1980, $11,300,000; 1981 $14,400,000; 1982 $14,400,000; 1983 $14,000,000; 1984 $9,400,000 and the expected earnings for 1985 are $10,400,000. An average for the period between 1981 to 1985 shows that normalized earnings were $12,500,000. Thus, on a normalized earnings approach Burns Foods is worth $172,000,000 to $192,000,000.

It was noted that if factors such as strikes, and a $13,500,000 pension fund overpayment are not taken into account then the normalized earnings for the period between 1980 and 1984 would be as follows; 1980 $13,200,000; 1981 $14,400,000; 1982 $9,600,000; 1983 $11,600,000 and 1984 $7,100,000. If $14,400,000 in 1984 earnings were used, notwithstanding a 30 percent acquisition premium and a 10.9 percent to 11.6 percent capitalization rate, then the normalized total value of Burns Foods would be in the range of $92,000,000 to $101,000,000.

It was also indicated that because the normalization approach to earnings uses market capitalization multiples and applies them to normalized earnings there is a double counting tendency in this valuation method. Mr. MacNaughton contended that it is appropriate to normalize earnings and to use market multiples. He did however note that there is some overlap in the market multiples used because they attempt to reflect that Burns Foods has some values that are not perfectly reflected in its earnings statement. Further, he indicated that in his opinion the range of values flowing from the projected earnings approach reflect the more appropriate value of the Burns Foods acquisition.

Under the perspective earnings approach, comparable the shares of Canadian food processing companies traded at approximately 10.9 to 11.6 times their earnings. These capitalization factors produced a range of values that Burns Foods would have traded in the public market during the first quarter of fiscal and calendar 1985 for $106,000,000 to $116,000,000 when a 30 percent acquisition premium and $7,000,000 in redundant assets are taken into account. Therefore, on the projected earnings approach the value of Burns Foods was $144,300,000 to $158,000,000.

The value of the consideration provided by Enterprises was determined to be 11.75 to 12.65 for the convertible securities and 12.25 and 13.25 for the retractable shares. Thus, the securities offered by Union Enterprises for Burns Foods were worth in the range between $117,500,000 and $130,300,000.

Dr. J. Baldwin

Dr. Baldwin an Associate Professor of Economics at Queen's University was retained by Ontario Energy Board Counsel. He addressed the following issues: pre-acquisition approval, the social contract, rules, and a compulsory market float.

Dr. Baldwin argued in favour of a pre-acquisition approval on the basis of a perceived need to screen owners of the utility. The identity of the owner may be important for public policy reasons (concentration of the market, foreign ownership or extra-provincial ownership for example) as the owner may not be a suitable partner in the social contract. The hearing would not be mandatory and would apply only to transfers of ownership of the parent company. It would not go back to the owner of the holding company. Hearings may have costs and may not solve all problems but they do represent an important option for review.

The market for corporate control is not necessarily more important in regulated industries. Efficiency is also enhanced by reason of effective regulation and competition for substitutes such as coal and oil. Therefore, pre-acquisition approval is not necessarily an impediment to utility efficiency simply because it may inhibit some takeover bids.

Historically in Canada, regulation is based upon "implicit agreements" between the industry and the regulator. Explicit agreements set out in defined rules are inflexible and often costly to maintain and enforce. The identity of the owner of the utility is important because of the mutual trust needed to maintain implicit agreements.

Rules or explicit agreements are also important. However, rules can not deal with all possible problems, which may arise in regulation. The prominence of rules in the United States has occurred for historic reasons. Specific rules will simplify takeovers, speed up any review of transfers of ownership which may be required and make the process more predictable.

Dr. Baldwin supports affiliated interest rules which regulate the transfer of goods between affiliates and financial transfers. He is not in favour of an established set of rules on dividend policy because this would be too restrictive.

A common float can reduce information costs to the regulator regarding the equity cost of capital. It may represent a more acceptable alternative to the regulator comparing the cost of capital to other industries further afield or to the imposition of rules restricting the diversification of holding companies because of the resulting difficulties in obtaining information.

Mr. T. R. Close

Mr. Close expressed the concerns of the Chatham and District Chamber of Commerce regarding the acquisition of Union Gas by Unicorp. Specifically, he enumerated the following concerns. The Chamber of Commerce was opposed to the concentration of ownership in the hands of a single individual and would prefer to have a utility which is widely held. It was concerned about Unicorp's speculative reputation because the continued existence of Union Gas is essential to the economic and social well being of the Chatham community. The Settlement Agreement and the Joint Undertakings were judged to be ineffectual in protecting the utility from problems relating to ownership and management. Mr. Close concluded by suggesting to the Board that it consider recommending the introduction of retroactive legislation requiring that the 20 percent rule of Section 26(2), which he interpreted on an absolute restriction be strictly enforced.

Messrs. D and N. McGeachy

Mr. D. McGeachy and Mr. N. McGeachy indicated that as minority shareholders representing the McGeachy Charitable Foundation they believed that they were treated unfairly. They said that while major institutions were able to obtain cash for their shares, individual shareholders were required to accept non-voting preferred shares. Also, Unicorp's reputation as compared to that enjoyed by the management of Union Gas will cause a serious down-grading of the utility's investment rating which will result in a higher cost for capital. They added that single ownership concentration within a utility, whether it occurs directly or indirectly, is not advisable because it effectively prohibits the small investor from investing in conservative low risk enterprises.

Mr. and Mrs. Nichol

Mr. and Mrs. Nichol appeared as minority shareholders of Union Enterprises and testified on their own behalf. Generally, they opposed the Unicorp acquisition of Union Enterprises, for two reasons. First, the offer made to the minority shareholders of Union Enterprises was financially inadequate and unfair. Second, a utility should not become part of a conglomerate because it is thus exposed to the risk of having its capital used to fund non-utility activities.

Mr. and Mrs. LaBombarde

Mr. and Mrs. LaBombarde appeared as minority shareholders of Union Enterprises and testified on their own behalf. They opposed the Unicorp acquisition on several grounds. First, the $12.50 price offered for the Union Enterprises shares was financially unfair. Also, a takeover offer should have been made for all shares. Second, dividends to be paid should not have been frozen for a three year period. Third, Unicorp's managerial philosophy is not compatible with operating a utility. Fourth, the 20 percent ownership rule in Section 26 (2) should be enforced as on absolute restriction on ownership. Fifth, Union Gas should not be permitted to diversify into non-utility activities.

Mr. T. A. Cline

Mr. Cline represented the Regional Municipality of Haldimand-Norfolk and The Corporation of the City of Chatham. He addressed issues relating to Section 26 (2) and the enforceability of undertakings.

Mr. Cline submitted that the 20 percent rule under Section 26(2) should be strictly enforced as an absolute restriction upon ownership. In the alternative he argued that where an exemption is sought it should be provided by the Ontario Energy Board pursuant to a public hearing and not by the Lieutenant Governor in Council. As a further alternative Mr. Cline suggested that the Ministry of Energy be notified of a change in control pursuant to which the Minister would give 60 days notice and invite submissions from the public.

He also expressed two concerns regarding the efficacy of the undertakings. First, he questioned the diligence of the Lieutenant Governor in Council in enforcing the undertakings. Second, he believed the OEB was powerless to monitor them.

Mr. C. M. Tatham

Mr. Tatham submitted representations on behalf of the County of Oxford.

At a meeting held on March 1, 1985 the representatives from seven southwestern Ontario Municipalities passed a resolution to the effect that a single shareholder should not be allowed to control more than 20 percent of the common shares of a utility. This resolution was passed for the following reasons. First, a franchise is a privilege granted to a utility by the customers of the municipality through their elected representatives. Second, the customers through their representatives should have a say in the rates charged and the percentage of shares owned by a single shareholder.

Mr. A. Kimpe

Mr. Kimpe appeared on his own behalf and indicated that as a landowner leasing storage to Union Gas he felt that he had not received just and fair compensation from the management of Union Gas.

Mr. Kimpe concluded that the conduct of Union Gas management could only change and improve with Unicorp's help and that they should be given an opportunity to prove themselves in this regard. Accordingly, he submitted, the Board should recommend that the Unicorp acquisition be approved.

Mr. S. Kawalec

Mr. Kawalec represented the opinions of certain intermediate and small volume industrial customers of Union Gas. Two concerns were expressed. First, the effect of the takeover upon rates. Second, the manner in which utilities should be owned and operated.

The holding company structure is difficult to monitor and regulate. Undertakings can only expose further loopholes and additional legislative rules and regulations regarding holding companies are not economically practical. However, additional rules and regulations regarding ownership and diversification should be imposed upon the activities of utilities.

Regarding diversification, Mr. Kawalec indicated that while his clients would prefer the utility not to diversify, particularly into higher risk enterprises, if such diversification does occur it should do so only with the permission of the Board. Further, where diversification into non-related enterprises has otherwise occurred such interests should be sold. He noted that customer relations would improve if utilities were restricted to utility activities. He said that his clients "only want straightforward, down the centre gas service. Surely, this is the original concept of monopoly gas utility ... how far we have strayed."

Mr. J. R. Connacher

Mr. Connacher, the Chairman and Chief Executive Officer of Gordon Capital appeared pursuant to a subpoena. He addressed matters relating to Gordon Capital's role in the Unicorp takeover of Union Enterprises.

Mr. Connacher indicated that Mr. Mann and Mr. Leech solicited the services of Gordon Capital because it enjoys the reputation of a firm dealing in large blocks of stock. Initially the company was instructed to purchase shares in Union Enterprises and when Gordon Capital had succeeded in obtaining approximately 200,000 shares, they were instructed to undertake a takeover bid.

During the course of the takeover Gordon Capital undertook to persuade shareholders of Union Enterprises to tender their shares. Institutions, banks and trust companies were encouraged to buy Union Enterprises' shares and to trade them in exchange for Unicorp preferred shares. The Unicorp preferred shares carried a rate of return of 12 percent as compared to a 8.5 to 9 percent rate of return available for other preferred shares trading on the market. Also, the preferred shares offered by Unicorp in exchange for Union Enterprises common shares were, due to tax advantages, very attractive to institutional investors.

Because they seem an attractive investment, a substantial number of Unicorp preferred share are currently owned by a loosely related group of companies associated with the Hees International Corporation. Representations were made to institutions outside this group. However, these other corporations were not prepared to act. The Hees International group of companies are significant purchasers of preferred shares, averaging $400,000,000 to $500,000,000 annually, and consequently were prepared to invest in Unicorp preferred shares.

Gordon Capital was successful in obtaining an average price of $12.50 in cash for the shares that it sold on behalf of its clients. The same price was available to individual shareholders because the closing stock price for Union Enterprises shares was above $12.00 for 39 out of 48 trading days. However, Mr. Connacher agreed with Mr. Kierans that if all outstanding shares in Union Enterprises had been tendered for example, on February 1, 1985 when the stock was trading at $12.50, there would be insufficient purchasing power in the market to purchase all shares at that price. Therefore, to the extent that a noninstitutional shareholder dealt with a recognized brokerage firm who had knowledge of how the market functions he would have been entitled to the $12.50 price.

Mr. T. Eyton

Mr. Eyton, the President and Chief Executive Officer of Brascan Limited also appeared persuant to a subpoena. He addressed the following issues: the sale of shares in Union Enterprises held by the Great Lakes Group, and the reasons behind the decision to purchase Unicorp preferred shares.

Mr. Eyton indicated that in 1980 Brascan purchased shares in Union Gas and subsequently transferred them to the Great Lakes Power group of companies. This investment constitutes less than 10 percent of the total holdings of the Great Lakes Group and is thus only a portfolio investment. The presence in 1980 of Darcy McKeough as the newly appointed Chief Executive Officer induced Brascan to make this investment. At no time did Brascan desire to increase its holdings in Union Enterprises beyond the 20 percent limit.

The Great Lakes Group decided to dispose of its shares in Union Enterprises for the following general reasons. First, the Great Lakes Group had informed the Union management of its desire to sell for the past two years. Second, the reorganization of Union Enterprises lacked managerial talent to successfully diversify. Third, the Unicorp share exchange offer satisfied the Great Lakes Group's criteria of placing the Union Enterprises shares with investors of their choice and of involvement with a responsible group.

The decision to exchange the shares held by the Great Lakes Group was made for the following specific reasons:

i) the Unicorp shares provided greater downside protection as compared against the uninflated market value of the Union Enterprises shares;
ii) Unicorp's management had a proven track record and had displayed a commitment which was backed by a substantial investment;
iii) Unicorp shares offered greater security of dividend and capital because Unicorp has a superior long term financial commitment to maintain the Union Enterprises common share dividend;
iv) Unicorp preferred shares offered a superior dividend yield to maturity in relation to other comparable securities, had an added right of retraction of the principal at seven years;

v) the warrants offered a risk free equity feature to participate in Unicorp's growth;

vi) the fixed rate dividend available on Unicorp shares provided an opportunity to match its asset - liability attributes at an attractive spread.

Since the shares are non-voting they do not provide the Great Lakes Group with any influence over Unicorp's affairs. In addition, there does not exist a collateral agreement or understanding with Unicorp regarding the Unicorp shares, and the Great Lakes Group never had an option to acquire Canada Trust shares or any other Unicorp investment positions.

Mr. J. Cockwell

Mr. Cockwell, the Executive Vice President and Chief Operating Officer of Brascan Limited, also appeared pursuant to a subpoena. He addressed the following matters: the Edper/Brascan Group holdings of Unicorp preferred shares, and the preferred share interlock between Union Shield Resources, Union Enterprises and Union Gas.

Mr. Cockwell described transactions for Unicorp preferred shares entered into by the Edper/Brascan Group of companies. All such transactions were undertaken by these companies in the normal course of business and were based exclusively on the individual investment needs of each company. Due regard was also given to the investment and tax merits afforded by the Unicorp securities. Because Unicorp enjoys an established track record, it can obtain financing, and therefore its preferred shares cannot be described as "junk bonds". Further, the Burns Foods purchase made additional blocks readily available to interested investors.

The Edper/Brascan Group possess special expertise in the preferred shares market, and this expertise has been transmitted to this group of companies. Nonetheless, investments within the Edper/Brascan Group are made on a strictly individual basis. However, Gordon Capital who acts on behalf of the individual companies is familiar with the investment needs of the group.

Mr. Cockwell believed that the preferred share interlock should have been set up by borrowing in the utility the full amount of $233,000,000. This would have restored the utility's full equity base and would have left the money in the utility for its use. A transaction of this nature would create a "ring fence" around the utility because the only recourse of the lending bank would be to the preferred share income. In this way the only obligation of the utility would be to pay the interest on the loan which could presumably be covered from its preferred share income. It was also suggested that if the parent had guaranteed the loan to the utility the bank would have recourse to the parent. This would provide additional protection to the utility.

Mr. Paul Reichmann

Mr. Reichmann, the Senior Executive Vice President and director of Olympia & York Development Limited filed an affidavit with the Board. He addressed the following matters: the role of Ontario 499977 and the decision to invest in Unicorp preferred shares.

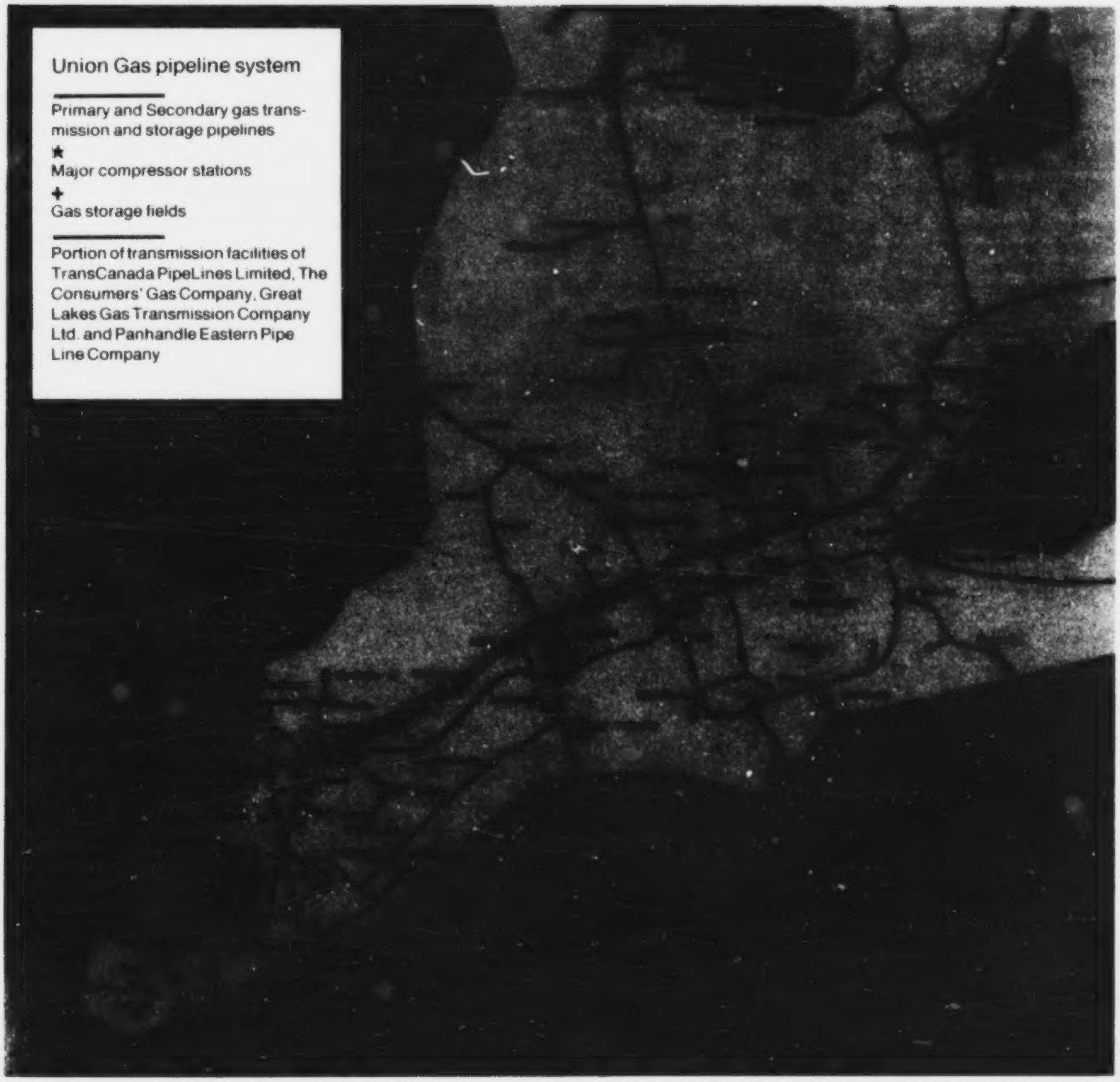
He explained that Ontario 499977 invests in marketable securities as a nominee for Olympia & York. This company currently holds approximately 2,000,000 preferred shares in Unicorp. The shares were purchased by Gordon Capital on the last day of the takeover bid at prices up to $12.50 per share.

This investment decision was based on the merits of the Unicorp securities and on tax reasons. Mr. Reichmann had no contact or discussions with the Edper/Brascan group of companies regarding this transaction. By reason of a prior holding of shares in Royal Trustco Limited, Olympia & York also owns 2,140,300 Class A voting shares and 1,496,968 Class II preferred shares series one, in Trilon Financial Corporation through a subsidiary of Olympia & York, namely, the Olympia & York Holdings Corporation. Through an investment in England Olympia

& York also has an investment interest in Trizec Corporation Limited. Mr. Reichman does not consider the Olympia & York group of companies to be connected to the Edper/Brascan group of companies as a result of these investments.

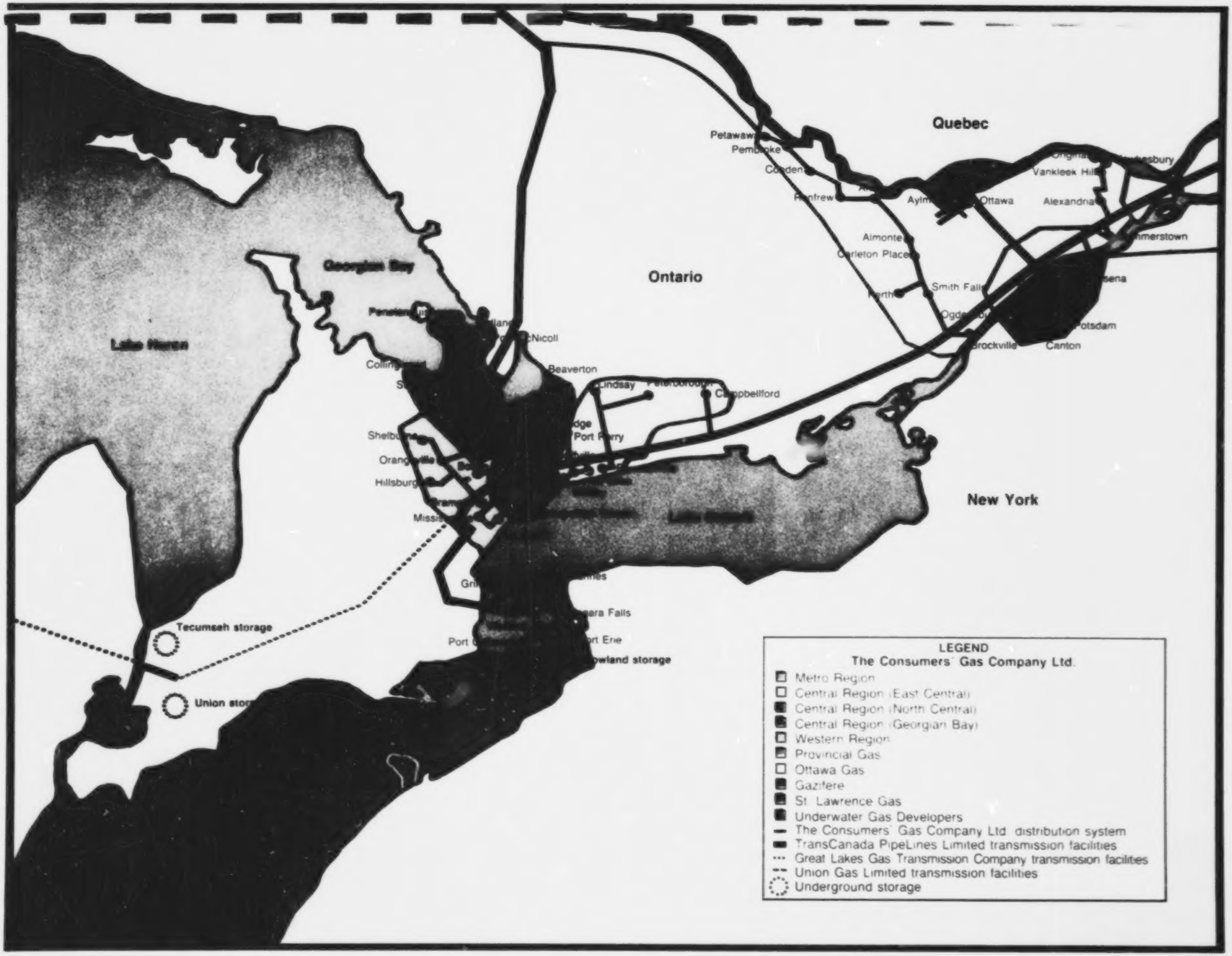
Appendix B. MAPS OF THE OPERATING AREAS OF THE THREE MAJOR NATURAL GAS UTILITIES

1. Union Gas Limited
2. The Consumers' Gas Company Ltd.
3. Northern and Central Gas Corporation Limited

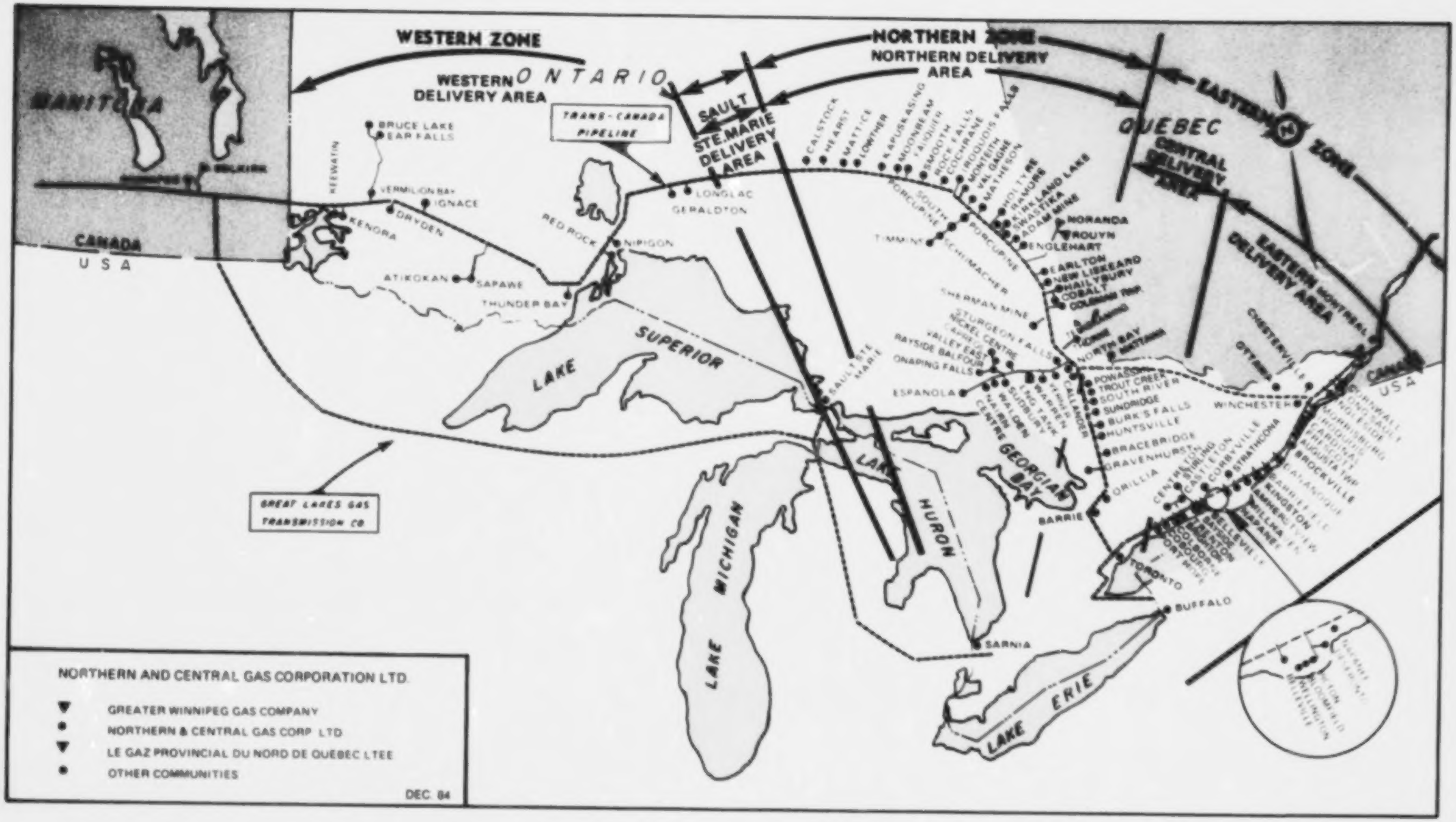


Union Gas pipeline system

—
Primary and Secondary gas transmission and storage pipelines
★
Major compressor stations
✚
Gas storage fields
—
Portion of transmission facilities of TransCanada PipeLines Limited, The Consumers' Gas Company, Great Lakes Gas Transmission Company Ltd. and Panhandle Eastern Pipe Line Company


Quebec
Ontario
New York
Georgian Bay
Lake Huron
Lake Ontario
Petawawa
Pembroke
Cobden
Renfrew
Aylmer
Ottawa
Orignal
Hawkesbury
Vankleek Hill
Alexandria
Williamstown
Almonte
Carleton Place
Perth
Smith Falls
Ogdensburg
Massena
Potsdam
Brockville
Canton
Campbellford
Peterborough
Lindsay
Port Perry
Beaverton
McNicoll
Collingwood
Shelburne
Orangeville
Hillsburgh
Mississauga
Grimsby
Niagara Falls
Port Erie
Port Colborne
Crowland storage
Tecumseh storage
Union storage
LEGEND
The Consumers' Gas Company Ltd.
Metro Region
Central Region (East Central)
Central Region (North Central)
Central Region (Georgian Bay)
Western Region
Provincial Gas
Ottawa Gas
Gazifere
St. Lawrence Gas
Underwater Gas Developers
The Consumers' Gas Company Ltd. distribution system
TransCanada PipeLines Limited transmission facilities
Great Lakes Gas Transmission Company transmission facilities
Union Gas Limited transmission facilities
Underground storage

DISTRIBUTION NETWORK


WESTERN ZONE
WESTERN DELIVERY AREA
ONTARIO
NORTHERN ZONE
NORTHERN DELIVERY AREA
SAULT STE.MARIE DELIVERY AREA
EASTERN ZONE
QUEBEC
CENTRAL DELIVERY AREA
EASTERN DELIVERY AREA
MANITOBA
SELKIRK
CANADA
USA
TRANS-CANADA PIPELINE
GREAT LAKES GAS TRANSMISSION CO
BRUCE LAKE
EAR FALLS
KEEWATIN
KENORA
VERMILION BAY
DRYDEN
IGNACE
ATIKOKAN
SAPAWE
THUNDER BAY
RED ROCK
NIPIGON
LONGLAC
GERALDTON
CALSTOCK
HEARST
MATTICE
LOWTHER
KAPUSKASING
MOONBEAM
FAUQUIER
SMOOTH ROCK FALLS
COCHRANE
IROQUOIS FALLS
MONTEITH
VAL GAGNE
MATHESON
HOLTYRE
RAMORE
KIRKLAND LAKE
SWASTIKA
ADAM MINE
NORANDA
ROUYN
ENGLEHART
EARLTON
NEW LISKEARD
HAILEYBURY
COBALT
COLEMAN TWP.
TIMMINS
SOUTH PORCUPINE
PORCUPINE
SCHUMACHER
SHERMAN MINE
STURGEON FALLS
NICKEL CENTRE
CAPREOL
VALLEY EAST
RAYSIDE BALFOUR
ONAPING FALLS
ESPANOLA
NAIRN CENTRE
WALDEN
SUDBURY
LNG TANK
WARREN
VERNER
CALLANDER
NORTH BAY
MATTAWA
POWASSAN
TROUT CREEK
SOUTH RIVER
SUNDRIDGE
BURK'S FALLS
HUNTSVILLE
BRACEBRIDGE
GRAVENHURST
ORILLIA
BARRIE
TORONTO
BUFFALO
SARNIA
SAULT STE MARIE
LAKE SUPERIOR
LAKE MICHIGAN
LAKE HURON
GEORGIAN BAY
LAKE ERIE
CENTRETON
STIRLING
CASTLETON
CORBYVILLE
STRATHCONA
COLBORNE
COBOURG
PORT HOPE
TRENTON
BAYSIDE
BELLEVILLE
NAPANEE
MILLHAVEN
AMHERSTVIEW
KINGSTON
BARRIEFIELD
GANANOQUE
BROCKVILLE
AUGUSTA TWP
PRESCOTT
CARDINAL
IROQUOIS
MORRISBURG
INGLESIDE
LONG SAULT
CORNWALL
WINCHESTER
CHESTERVILLE
OTTAWA
MONTREAL
PICTON
BLOOMFIELD
WELLINGTON
NORTHERN AND CENTRAL GAS CORPORATION LTD.
▼ GREATER WINNIPEG GAS COMPANY
● NORTHERN & CENTRAL GAS CORP LTD
▼ LE GAZ PROVINCIAL DU NORD DE QUEBEC LTEE
● OTHER COMMUNITIES
DEC 84

NCgas

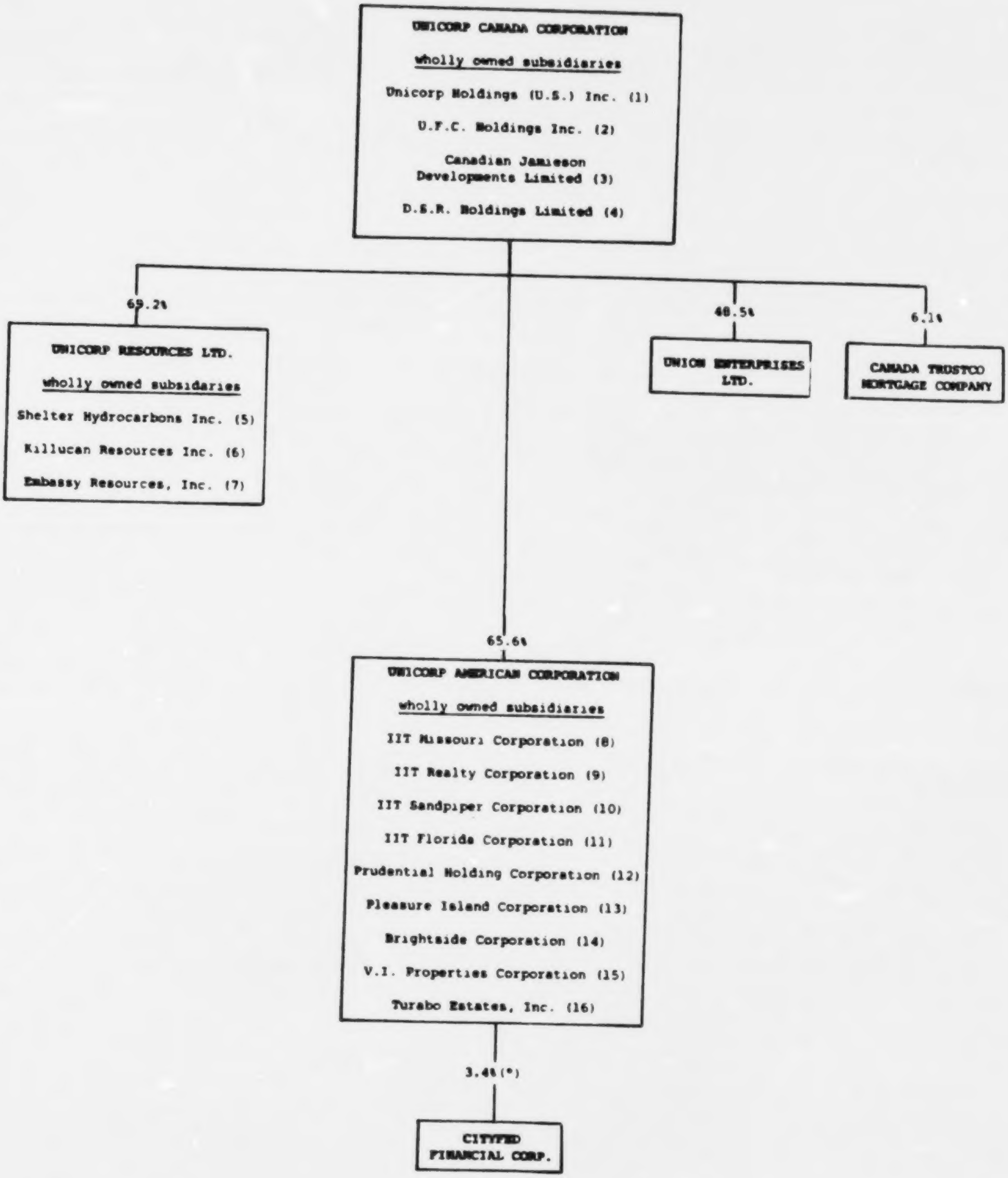
NORTHERN AND CENTRAL GAS CORPORATION LIMITED

Appendix C. CORPORATE ORGANIZATION STRUCTURE

1. Unicorp Canada Corporation
2. Union Enterprises Ltd.
3. Hiram-Walker Resources Ltd.
4. Inter-City Gas Corporation
5. Hees International Corporation

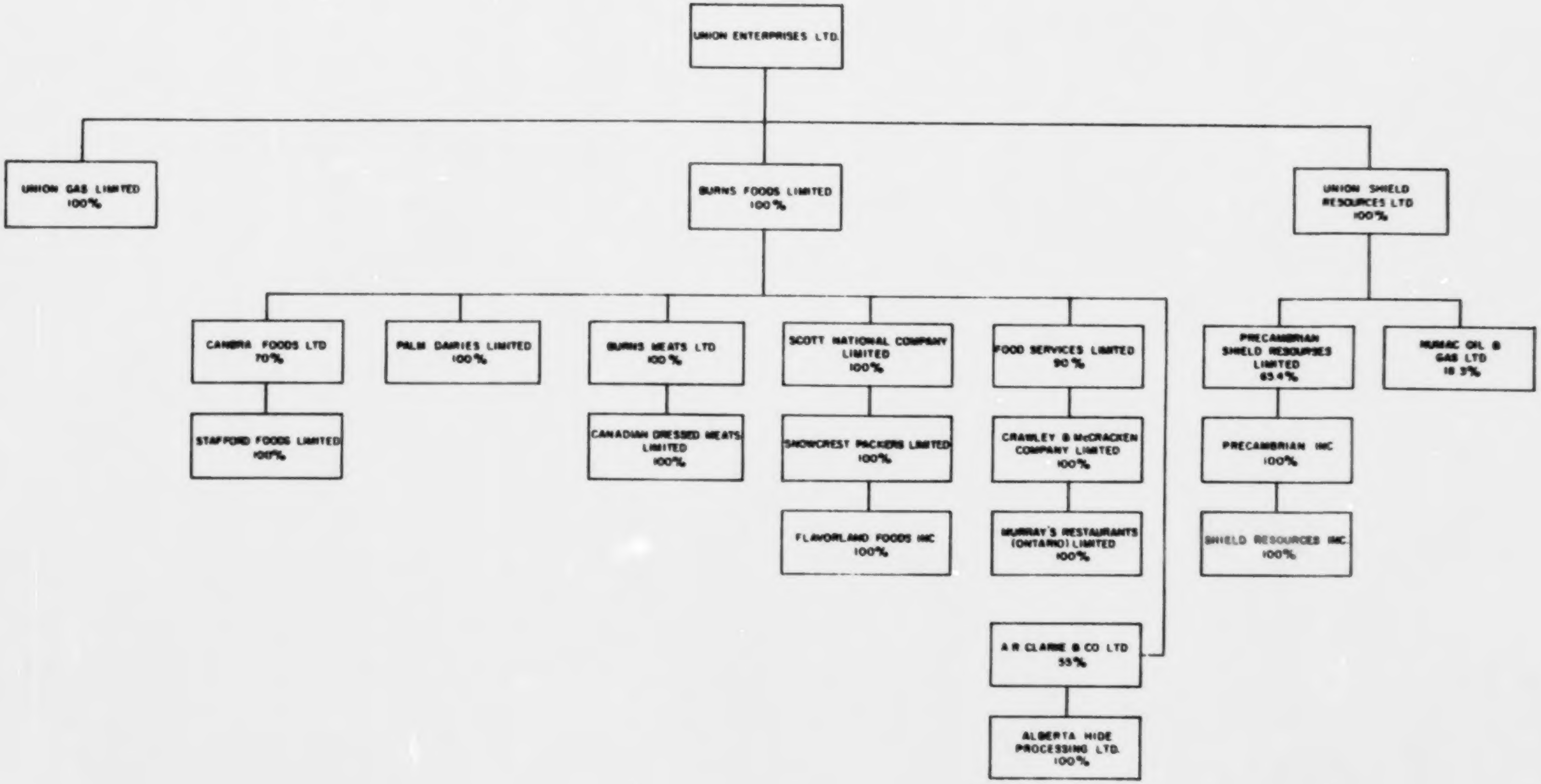
UNICORP CANADA CORPORATION

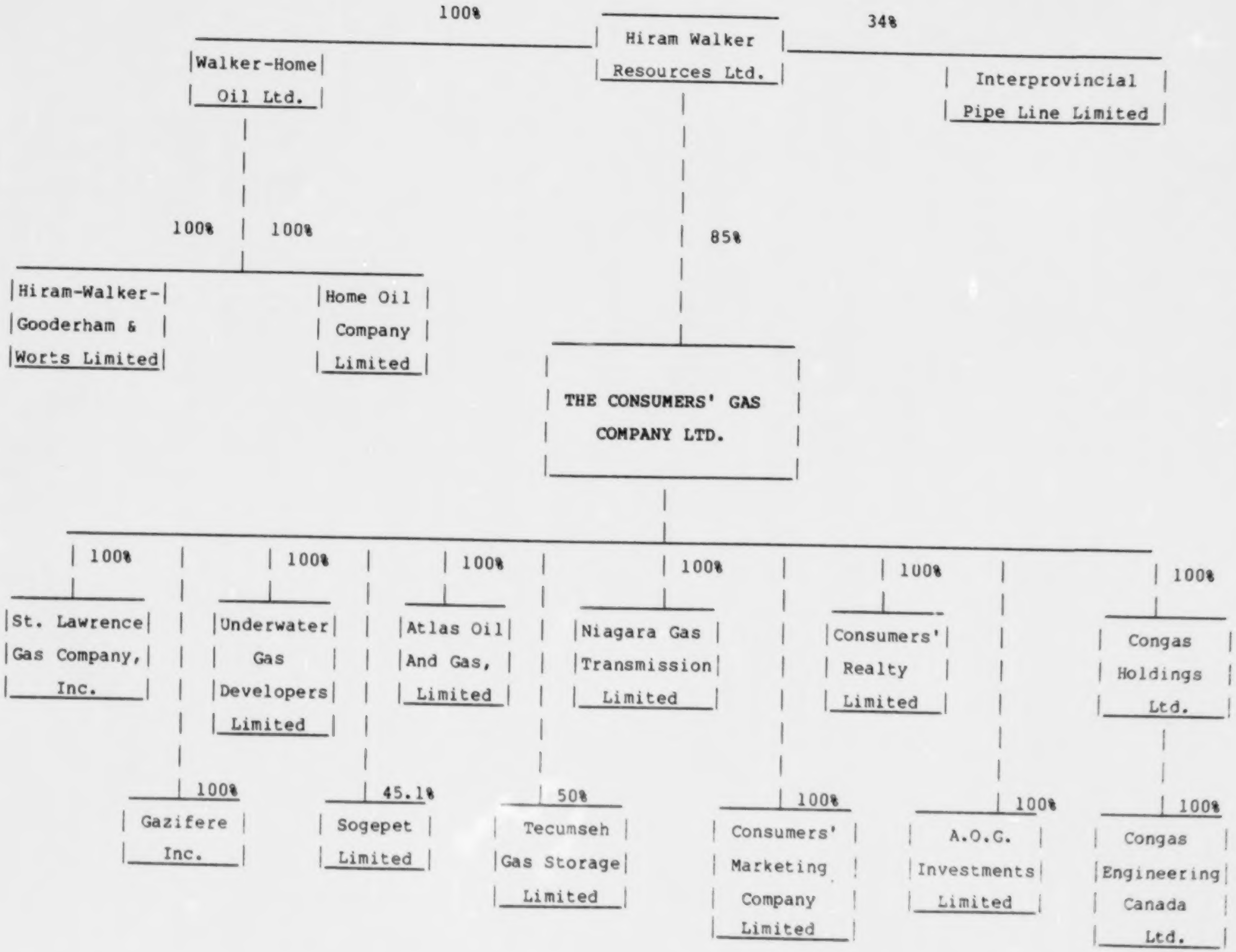
SUBSIDIARIES
AND ASSOCIATED COMPANIES
(PERCENTAGE VOTING INTEREST)


UNICORP CANADA CORPORATION
wholly owned subsidiaries
Unicorp Holdings (U.S.) Inc. (1)
U.F.C. Holdings Inc. (2)
Canadian Jamieson Developments Limited (3)
D.S.R. Holdings Limited (4)
69.2%
UNICORP RESOURCES LTD.
wholly owned subsidaries
Shelter Hydrocarbons Inc. (5)
Killucan Resources Inc. (6)
Embassy Resources, Inc. (7)
48.5%
UNION ENTERPRISES LTD.
6.1%
CANADA TRUSTCO MORTGAGE COMPANY
65.6%
UNICORP AMERICAN CORPORATION
wholly owned subsidiaries
IIT Missouri Corporation (8)
IIT Realty Corporation (9)
IIT Sandpiper Corporation (10)
IIT Florida Corporation (11)
Prudential Holding Corporation (12)
Pleasure Island Corporation (13)
Brightside Corporation (14)
V.I. Properties Corporation (15)
Turabo Estates, Inc. (16)
3.4%(*)
CITYFED FINANCIAL CORP.

(*) 8.2% voting interest calculated on a fully diluted basis.

See accompanying footnotes for a description of wholly owned subsidiaries.


UNION ENTERPRISES LTD.
UNION GAS LIMITED 100%
BURNS FOODS LIMITED 100%
UNION SHIELD RESOURCES LTD 100%
CANBRA FOODS LTD 70%
STAFFORD FOODS LIMITED 100%
PALM DAIRIES LIMITED 100%
BURNS MEATS LTD 100%
CANADIAN DRESSED MEATS LIMITED 100%
SCOTT NATIONAL COMPANY LIMITED 100%
SNOWCREST PACKERS LIMITED 100%
FLAVORLAND FOODS INC 100%
FOOD SERVICES LIMITED 90%
CRAWLEY & McCRACKEN COMPANY LIMITED 100%
MURRAY'S RESTAURANTS (ONTARIO) LIMITED 100%
A R CLARKE & CO LTD 53%
ALBERTA HIDE PROCESSING LTD. 100%
PRECAMBRIAN SHIELD RESOURCES LIMITED 65.4%
PRECAMBRIAN INC 100%
SHIELD RESOURCES INC. 100%
NUMAC OIL & GAS LTD 18.3%


Hiram Walker Resources Ltd.
100%
34%
Walker-Home Oil Ltd.
Interprovincial Pipe Line Limited
100%
100%
85%
Hiram-Walker-Gooderham & Worts Limited
Home Oil Company Limited
THE CONSUMERS' GAS COMPANY LTD.
100%
St. Lawrence Gas Company, Inc.
100%
Underwater Gas Developers Limited
100%
Atlas Oil And Gas, Limited
100%
Niagara Gas Transmission Limited
100%
Consumers' Realty Limited
100%
Congas Holdings Ltd.
100%
Gazifere Inc.
45.1%
Sogepet Limited
50%
Tecumseh Gas Storage Limited
100%
Consumers' Marketing Company Limited
100%
A.O.G. Investments Limited
100%
Congas Engineering Canada Ltd.

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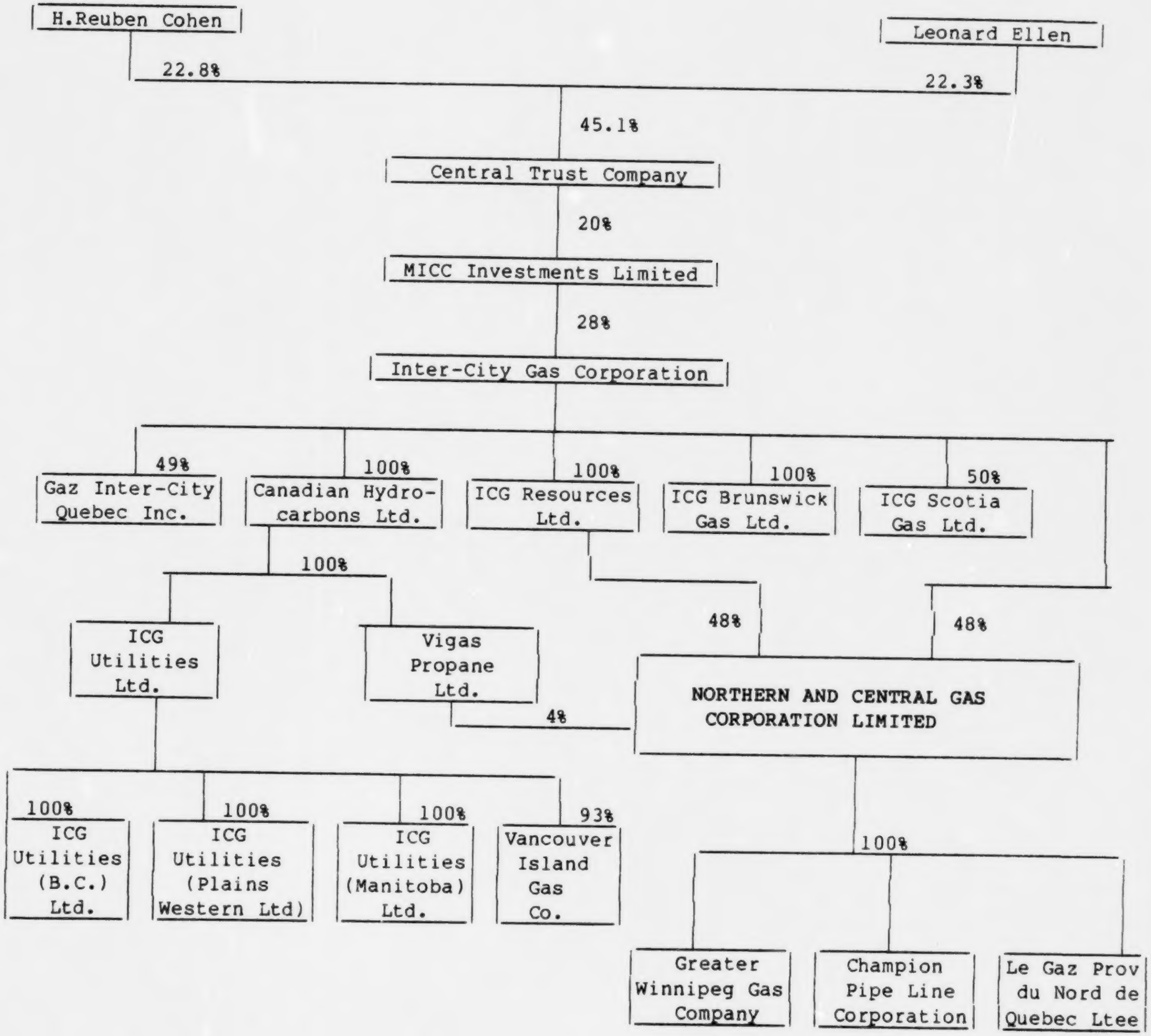
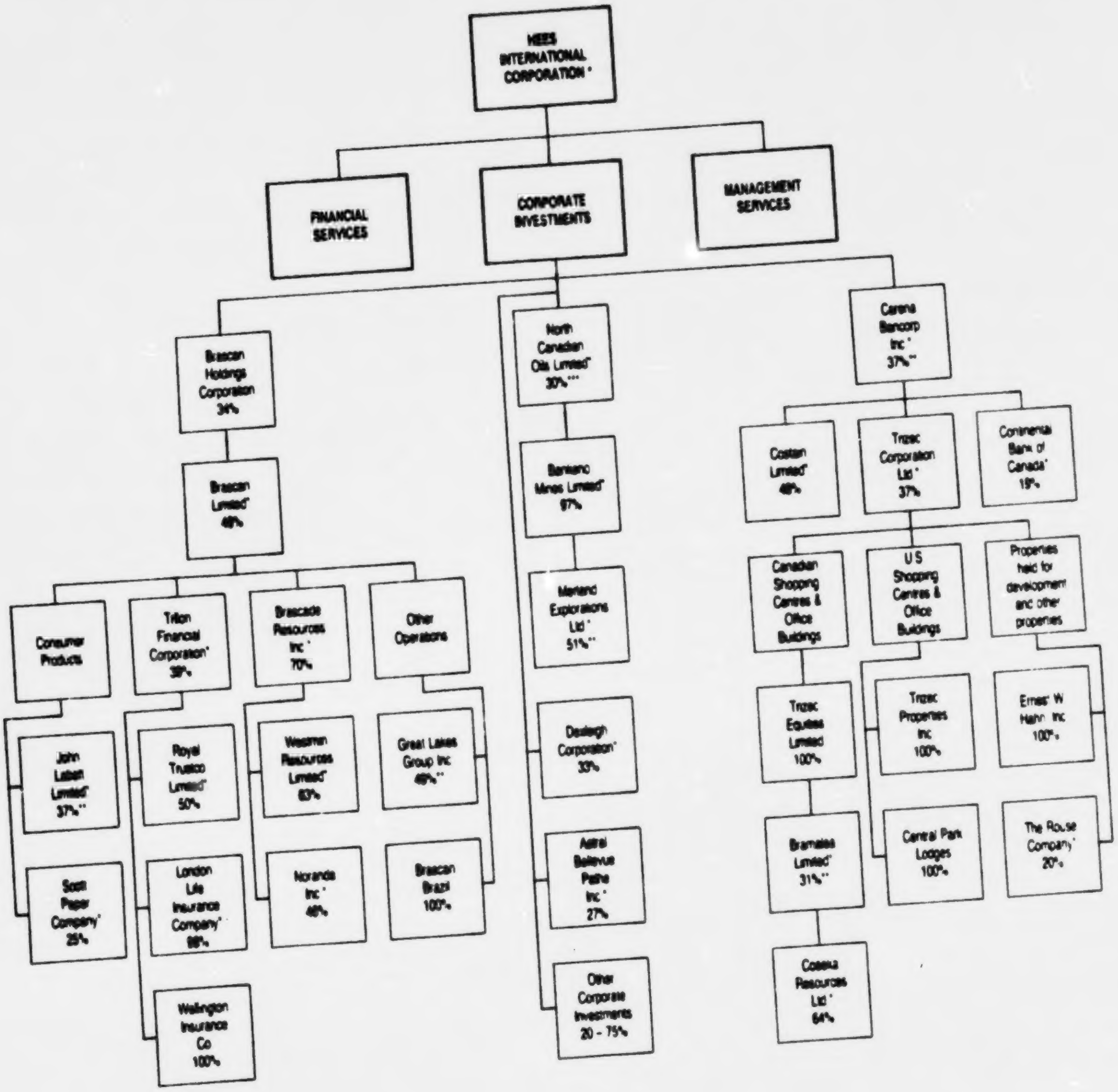

H.Reuben Cohen
Leonard Ellen
22.8%
22.3%
45.1%
Central Trust Company
20%
MICC Investments Limited
28%
Inter-City Gas Corporation
49%
Gaz Inter-City Quebec Inc.
100%
Canadian Hydro-carbons Ltd.
100%
ICG Resources Ltd.
100%
ICG Brunswick Gas Ltd.
50%
ICG Scotia Gas Ltd.
100%
ICG Utilities Ltd.
Vigas Propane Ltd.
48%
48%
4%
NORTHERN AND CENTRAL GAS CORPORATION LIMITED
100%
ICG Utilities (B.C.) Ltd.
100%
ICG Utilities (Plains Western Ltd)
100%
ICG Utilities (Manitoba) Ltd.
93%
Vancouver Island Gas Co.
100%
Greater Winnipeg Gas Company
Champion Pipe Line Corporation
Le Gaz Prov du Nord de Quebec Ltee


HEES INTERNATIONAL CORPORATION *
FINANCIAL SERVICES
CORPORATE INVESTMENTS
MANAGEMENT SERVICES
Brascan Holdings Corporation 34%
Brascan Limited* 48%
Consumer Products
Trilon Financial Corporation* 39%
Brascade Resources Inc * 70%
Other Operations
John Labatt Limited* 37%**
Scott Paper Company* 25%
Royal Trustco Limited* 50%
London Life Insurance Company* 98%
Wellington Insurance Co 100%
Westmin Resources Limited* 63%
Noranda Inc * 46%
Great Lakes Group Inc 46%**
Brascan Brazil 100%
North Canadian Oils Limited* 30%***
Bankeno Mines Limited* 97%
Merland Explorations Ltd * 51%**
Dexleigh Corporation* 33%
Astral Bellevue Pathe Inc * 27%
Other Corporate Investments 20 - 75%
Carena Bancorp Inc * 37%**
Coscan Limited* 48%
Trizec Corporation Ltd * 37%
Continental Bank of Canada* 19%
Canadian Shopping Centres & Office Buildings
U S Shopping Centres & Office Buildings
Properties held for development and other properties
Trizec Equities Limited 100%
Bramalea Limited* 31%**
Coseka Resources Ltd * 64%
Trizec Properties Inc 100%
Central Park Lodges 100%
Ernest W Hahn Inc 100%
The Rouse Company* 20%

* Public companies.
** On a fully-diluted basis.
*** Direct and indirect on a fully-diluted basis.

Appendix D. UNDERTAKINGS AND ORDERS IN COUNCIL

When there has been a change in the ownership or control of one of the three major Ontario natural gas utilities, undertakings have been offered to the Lieutenant Governor with the purpose of assuring continued service to the utilty's customers. The text of these undertakings is given here together with the accompanying Order in Council.

1. Newco, relating to the takeover of Northern and Central Gas Corporation Limited (August 15, 1975)................D/3
2. Hiram Walker - Consumers Home Ltd., upon reorganization (April 21, 1981).....D/11
3. Inter-City Gas Corporation, etc., and Northern and Central Gas Corporation Limited (January 18, 1985)...............D/19
4. Union Gas Limited and Union Enterprises Ltd. on reorganization (December 14, 1984)......................D/27
5. Unicorp Canada Corporation and Union Enterprises Ltd. following the takeover (1985).........................D/33

UNDERTAKING OF NEWCO LTD.

As provided for in Order-in-Council No. 2116/75, Newco Ltd. hereby undertakes to the Lieutenant Governor in Council of Ontario on its own behalf and on behalf of Norcen Energy Resources Limited ("Norcen"), a company to be formed by the amalgamation of Newco Ltd. and Canadian Industrial Gas & Oil Ltd. ("Cigol"), that so long as Norcen and its successors have a sufficient number of the outstanding voting shares of Northern and Central Gas Corporation Limited to enable the former to exercise corporate control over Northern and Central Gas Corporation Limited, and so long as the latter company, itself or through an affiliate or subsidiary, shall carry on the business of distributing natural gas in Ontario, Norcen will,

(i) review annually with the Minister of Energy, with such detail as he may reasonably require, the present and future gas supply position of Northern and Central Gas Corporation Limited;

(ii) provide timely prior notification to the Lieutenant Governor in Council of any development or occurrence (of which Norcen has knowledge or information) following which control of Norcen (and indirectly therefore control of Northern and Central Gas Corporation Limited) could be acquired by any person or corporation distributing natural gas in Ontario;

(iii) Newco Ltd. will cause Norcen, upon its incorporation, to apply for and use its best efforts to obtain, and if granted to keep current, an exemption from the requirement to obtain approval to issue equity capital under the Alberta Gas Utilities Act similar to that now held by Cigol;

(iv) cause such portion of the earnings of Northern and Central Gas Corporation Limited to be retained as is appropriate for retention by a gas distribution utility, and to the extent that such retained earnings are not sufficient to maintain the equity of Northern and Central Gas Corporation Limited at a level sufficient to enable Northern and Central Gas Corporation Limited to carry on its business of distributing gas in Ontario, Norcen will provide additional equity capital sufficient for that purpose, on terms at least as favourable as Northern and Central Gas Corporation Limited could have obtained itself directly from the market if the reorganization had not occurred; and, in the event an exemption is not obtained by Norcen from the Public Utilities Board of Alberta, in respect of the requirement, under the Alberta Gas Utilities Act, (mentioned in subclause (iii) for prior approval to issue capital, and Norcen is unable to obtain approval under that Act to supply such additional equity to Northern and Central Gas Corporation Limited, and is otherwise unable to supply such equity, Norcen agrees and undertakes to permit Northern and Central Gas Corporation Limited itself to raise equity from other sources including the issue of shares to the public, if required to carry on such business;

(v) Norcen will repay in each of the calendar years 1980 to 1999 inclusive an amount equal to 5% of the original principal amount of the demand promissory note to be issued by it to Northern and Central Gas Corporation Limited pursuant to the provisions of the scheme of arrangement dated December 11, 1974 by Northern and Central Gas Corporation Limited pursuant to section 193 of The Business Corporations Act, provided that all payments of principal of the said promissory note, whether made at the option of Norcen or as a result of a demand for payment by Northern and Central Gas Corporation Limited, will be applied in satisfaction of the payments due hereunder as they fall due.

IN WITNESS WHEREOF Newco Ltd. has executed this undertaking under its corporate seal at Toronto, Ontario on the 15th day of August, 1975.

NEWCO LTD.

per:____________________
President

per:____________________
Director

Ontario

Executive Council

O.C. 2116/75

Copy of an Order-in-Council approved by Her Honour the Lieutenant Governor, dated the 30th day of July, A.D. 1975.

The Committee of Council have had under consideration the report of the Honourable the Minister of Energy, wherein he states that,

WHEREAS Newco Limited applied to the Ontario Energy Board for leave to be granted by the Lieutenant Governor in Council, pursuant to section 26(2) of The Ontario Energy Board Act, to enable Newco Limited to acquire all of the outstanding voting shares of Northern and Central Gas Corporation Limited, and the Ontario Energy Board, after a hearing, in its Report and Opinion, recommending that such leave be granted, subject to the terms and conditions hereinafter mentioned in paragraph A;

AND WHEREAS, after consideration of the said Report and Opinion, the Minister of Energy initiated discussions with Newco Limited pursuant to which Newco Limited agreed, upon the leave applied for being granted, to give the several undertakings hereinafter mentioned in paragraph B;

The Honourable the Minister of Energy recommends that, effective on and after July 31, 1975, leave be granted to Newco Limited, pursuant to section 26(2) of The Ontario Energy Board Act, to acquire all of the outstanding voting shares of Northern and Central Gas Corporation Limited,

A. As recommended by The Ontario Energy Board, subject to the following terms and conditions that the acquisition be,

(a) carried out in accordance with the scheme of arrangement, dated December 11, 1974, pursuant to section 193 of The Business Corporation Act, for the purpose of carrying out the amalgamation agreement of the same date between Newco Ltd. and Canadian Industrial Gas & Oil Ltd. ("Cigol"), without any modification or alteration of either unless it shall have been consented to by the Lieutenant Governor in Council; and

(b) made no later than December 31, 1975, or, if the amalgamation is not then completed, by such later date as shall have been consented to by the Lieutenant Governor in Council;

B. And upon Newco Ltd. providing to the Lieutenant Governor in Council the undertakings set out below with an assurance satisfactory to the Lieutenant Governor in Council that such undertakings shall be performed by Newco Ltd., or Norcen Energy Resources Limited ("Norcen"), namely,

(c) so long as Norcen and its successors have a sufficient number of the outstanding voting shares of Northern and Central Gas Corporation Limited to enable the former to exercise corporate control over Northern and Central Gas Corporation Limited, and so long as the latter Company, itself or through an affiliate or subsidiary, shall carry on the business of distributing natural gas in Ontario, Norcen will,

(i) review annually with the Minister of Energy, with such detail as he may reasonably require, the present and future gas supply position of Northern and Central Gas Corporation Limited;

(ii) provide timely prior notification to the Lieutenant Governor in Council of any development or occurrence (of which Norcen has knowledge or information) following which control of Norcen (and indirectly therefore control of Northern and Central Gas Corporation Limited) could be acquired by any person or corporation distributing natural gas in Ontario;

(iii) Newco Ltd. will cause Norcen, upon its incorporation, to apply for and use its best efforts to obtain, and if granted to keep current, an exemption from the requirement to obtain approval to issue equity capital under the Alberta Gas Utilities Act similar to that now held by Cigol;

(iv) cause such portion of the earnings of Northern and Central Gas Corporation Limited to be retained as is approriate for retention by a gas distribution utility, and to the extent that such retained earnings are not sufficient to maintain the equity of Northern and Central Gas Corporation Limited at a level sufficient to enable Northern and Central Gas Corporation Limited to carry on its business of distributing gas in Ontario, Norcen will provide additional equity capital sufficient for that purpose, on terms at least as favourable as Northern and Central Gas Corporation Limited could have obtained itself directly from the market if the reorganization had not occurred; and, in the event an exemption is not obtained by Norcen from the Public Utilities Board of Alberta, in respect of the requirement, under the Alberta Gas Utilities Act, (mentioned in subclause (iii) for prior approval to issue capital, and Norcen is unable to obtain approval under that Act to supply such additional equity to Northern and Central Gas Corporation Limited, and is otherwise unable to supply such equity, Norcen agrees and undertakes to permit Northern and Central Gas Corporation Limited itself to raise equity from other sources including the issue of shares to the public, if required to carry on such business;

(v) Norcen will repay in each of the calendar years 1980 to 1999 inclusive an amount equal to 5% of the original principal amount of the demand promissory note to be issued by it to Northern and Central Gas Corporation Limited pursuant to the provisions of the said scheme of arrangement, provided that all payments of principal of the said promissory note, whether made at the option of Norcen or as a result of a demand for payment by Northern and Central Gas Corporation Limited, will be applied in satisfaction of the payments due hereunder as they fall due.

The Committee of Council concur in the recommendation of the Honourable the Minister of Energy and advise that the same be acted on.

Certified,

O. C. Mowat

Acting Clerk, Executive Council.

HIRAM WALKER RESOURCES LTD.

TO: THE LIEUTENANT GOVERNOR IN COUNCIL FOR THE PROVINCE OF ONTARIO

WHEREAS Hiram Walker-Consumers Home Ltd. (the "Corporation") has proposed to its shareholders a reorganization whereby a holding company will be established which will own shares of subsidiary companies carrying on the utility business, the distilled spirits business and the oil and gas exploration business; and

WHEREAS the said reorganization will be accomplished by an arrangement pursuant to The Business Corporations Act whereby shareholders of the Corporation (with the exception of the holders of the Group 1 Preference Shares) will by automatic share exchange receive substantially identical shares of Hiram Walker Resources Ltd. ("HWR"), which is presently a subsidiary of the Corporation, and HWR will become the owner of all of the issued shares of the Corporation except the said Group 1 Preference Shares; and

WHEREAS it is a condition of the reorganization that the Lieutenant Governor in Council shall have given its permission to the above-mentioned exchange of shares pursuant to or exempted the parties from compliance with the provisions of The Ontario Energy Board Act (the "Act") without imposing any term or condition which in the opinion of the directors of the Corporation, would be unduly detrimental to the interest of the Corporation or its shareholders; and

WHEREAS in order to induce the Lieutenant Governor in Council to so grant its permission or exempt the parties from compliance with the Act, HWR has agreed to give certain undertakings to the Lieutenant Governor in Council.

NOW THEREFORE HWR hereby undertakes that so long as HWR and its successors have a sufficient number of the outstanding voting shares of the Corporation to exercise control over the Corporation, and so long as the Corporation, itself or through an affiliate or subsidiary, shall carry on the business of distributing natural gas in Ontario, HWR will

(a) provide timely notification to the Lieutenant Governor in Council of any development or occurrence (of which HWR has knowledge) which could reasonably result in the acquisition by any person of such number of any class of shares of HWR which, together with shares already held by such person or by such person and an associate or associates of such person will in the aggregate exceed 20 per cent of the shares outstanding of that class (other than a mortgage or charge to secure a loan or indebtedness or to secure any bond, debenture or other evidence of indebtedness), the words "person" and "associate" to have the meaning prescribed by The Ontario Energy Board Act;

(b) cause to be provided to the Corporation an additional $189 million of equity through the subscription of HWR or a third party or third parties for additional common shares of the Corporation, such additional equity to be provided to the Corporation prior to September 30, 1981;

(c) cause to be retained in the Corporation such portion of the earnings of the Corporation as may be appropriate from time to time for retention by a gas distribution utility, and to the extent that, at any time, such retained earnings are not sufficient to maintain the equity of the Corporation at a level appropriate for a gas distribution utility company to provide, within a reasonable length of time, additional equity capital sufficient for that purpose, either directly or from other sources, including the issue of shares to the public, provided that a reasonable rate of return on equity capital be allowed. For the purposes of this undertaking, HWR shall be bound by a determination of the Ontario Energy Board (the "Board") of an appropriate level of equity capital up to the level which the Board found to be appropriate for the purposes of the Corporation's rate hearing held in the fall of 1980, as set forth in the Board's reasons for decision dated January 30, 1981;

(d) cause the board of directors of the Corporation to be comprised of a majority of directors who are independent of HWR and are representative of the communities in which the utility business is carried on provided that the term "representative" as used herein shall not be confined to persons who are elected or appointed officials of local government or agencies thereof; and

(e) not permit or direct the Corporation to borrow for or guarantee the obligations of HWR or other subsidiaries of HWR.

DATED this 21st day of April, 1981.

HIRAM WALKER RESOURCES LTD.

by:

W.P. Wilder

President and Chief
Executive Officer

Ontario
Executive Council

Order in Council

On the recommendation of the undersigned, the Lieutenant Governor, by and with the advice and concurrence of the Executive Council, orders that

the appended Regulation be made under the Ontario Energy Board Act.

Recommended ______________________
Minister of Energy

Concurred George R. McCague
Chairman

Approved and Ordered May 14, 1981
Date

____
Lieutenant Governor

D/16

R O.C. 200 / 81

REGULATION TO AMEND
REGULATION 626 OF REVISED REGULATIONS OF ONTARIO, 1970
MADE UNDER THE
ONTARIO ENERGY BOARD ACT

1. Regulation 626 of Revised Regulations of Ontario, 1970 is amended by adding thereto the following section:

> 5c. Hiram Walker Resources Ltd. is exempted from the operation of or compliance with subsection 26(2) of the Act in respect of the acquisition by way of share exchange of all of the outstanding 7-1/2 per cent voting preference shares, 9 per cent convertible preference shares and common shares of Hiram Walker-Consumers Home Ltd. pursuant to an arrangement made under the provisions of the Business Corporations Act between Hiram Walker-Consumers Home Ltd. and its shareholders dated the fifteenth day of December, 1980.

UNDERTAKINGS

TO: THE LIEUTENANT GOVERNOR IN COUNCIL OF
THE PROVINCE OF ONTARIO

WHEREAS Inter-City Gas Corporation, ICG Resources Ltd. and Vigas Propane Ltd. (herein together referred to as "Inter-City") by an agreement dated October 30, 1984 have agreed to buy and Norcen Energy Resources Limited ("Norcen") has agreed to sell all of the common shares of Northern and Central Gas Corporation Limited ("Northern");

AND WHEREAS, as part of the said transaction, Northern will transfer to Inter-City Gas Corporation an unsecured demand note issued by Norcen payable to Northern on which there is currently outstanding approximately $47 million, receiving in return an identical promissory note (the "Inter-City Note") issued by Inter-City Gas Corporation and payable to Northern;

AND WHEREAS the said transaction cannot be concluded without first obtaining the leave of the Lieutenant Governor in Council pursuant to Section 26 of the Ontario Energy Board Act;

AND WHEREAS pursuant to the said Act, the Ontario Energy Board has, following a public hearing, submitted to the Lieutenant Governor in Council its report and opinion dated January 16, 1985;

AND WHEREAS the Board's opinion is that with the provision of a bank guarantee of the Inter-City Note and certain undertakings by Inter-City, the transaction will meet the test of the public interest and would be recommended for approval:

NOW THEREFORE with a view to persuading the Lieutenant Governor in Council to grant the leave necessary under Section 26 of the Ontario Energy Board Act to enable the said transaction to be concluded, the undersigned do hereby jointly and severally undertake and agree as follows, for so long as Inter-City and its successors have a sufficient number of the outstanding voting shares of Northern to enable Inter-City to exercise corporate control over Northern, and for so long as Northern, itself or through a corporation over which it exercises corporate control, shall carry on the business of distributing natural gas in Ontario:

1. Inter-City and Northern will cause such portion of the current and future earnings of Northern to be retained in Northern as is from time to time appropriate for retention by a gas distribution utility regulated by the Ontario Energy Board, and to the extent that such retained earnings are not sufficient to maitain the equity of Northern at a level from time to time deemed appropriate for Northern by the Ontario Energy Board, Inter-City will provide additional equity capital sufficient for that purpose, on terms at least as favourable as Northern could itself obtain directly from the market; and, in the event Inter-City is unable or unwilling to supply such equity, Inter-City agrees and undertakes to permit Northern itself to raise equity from other sources including the issuance of shares to the public.

2. Northern will not pay dividends, or redeem, purchase or otherwise reduce or affect the amount or level of shareholders' equity of Northern, except in accordance with a dividend or distribution policy consistent with applicable business corporations statutes, trust indentures and Ontario Energy Board findings as to appropriate levels of equity of Northern.

3. Northern shall not borrow for, make loans or advances to, guarantee the obligations of or otherwise assume or become responsible for the obligations of Inter-City or any body directly or indirectly owned or controlled by Inter-City, without the prior consent of the Minister of Energy of Ontario.

4. The undersigned shall give timely notice to the Lieutenant Governor in Council of any occurrence (including, without limitation, any known, proposed or intended sale, disposition or transfer of shares of Northern or Inter-City) known to them which could result in any person acquiring such number of voting shares of Northern or Inter-City which, together with shares held by such person and by an associate or associates of such person, will in the aggregate exceed 20% of the voting shares outstanding of Northern or Inter-City (using, for the purpose of this Undertaking, the definitions provided in the Ontario Energy Board Act).

5. None of the costs of or incidental to the said transaction will be borne by Northern or included in the utility cost-of-service calculations of Northern or Inter-City Gas Corporation.

6. Northern's head office and main operating office shall be maintained in Ontario.

7. Northern will maintain on its Board of Directors at least two residents of its franchise area who at the time of their election or appointment have no pecuniary interest in Inter-City consolidated and no business connection with Inter-City consolidated, Northern, or any other natural gas distribution or transmission company.

8. Inter-City and Northern shall make reasonable efforts to accomplish a restructuring of Northern such that there will result a corporation whose assets, liabilities and activities relate only to the regulated natural gas distribution business in Ontario.

9. Inter-City will pay the principal on the Inter-City Note in instalments or $1,672,000 on December 31, 1988 and $4,148,000 on December 31 in each year 1989 to 1999 inclusive, or on such accelerated basis as the parties thereto may agree upon.

10. Inter-City shall, without expense to Northern, forthwith arrange a guarantee by a Canadian chartered bank of the Inter-City Note, the same to be maintained in force for so long as the Inter-City Note is held directly or indirectly by the corporation which operates the regulated natural gas distribution business in Ontario presently operated by Northern.

IN WITNESS WHEREOF the undersigned have respectively caused these presents to be executed this 18th day of January 1985.

INTER-CITY GAS CORPORATION

Per ____________________

ICG RESOURCES LTD.

Per ____________________

VIGAS PROPANE LTD.

Per ____________________

NORTHERN AND CENTRAL GAS
CORPORATION LIMITED

Per ____________________
President.

Ontario
Executive Council

Order in Council

On the recommendation of the undersigned, the Lieutenant Governor, by and with the advice and concurrence of the Executive Council, orders that

WHEREAS Inter-City Gas Corporation, ICG Resources Ltd. and Vigas Propane Ltd. (herein together referred to as "Inter-City") by an agreement dated October 30, 1984 have agreed to buy and Norcen Energy Resources Limited ("Norcen") has agreed to sell all of the common shares of Northern and Central Gas Corporation Limited ("Northern");

AND WHEREAS, as part of the said transaction, Northern will transfer to Inter-City Gas Corporation an unsecured demand note issued by Norcen payable to Northern on which there is currently outstanding approximately $47 million, receiving in return an identical promissory note (the "Inter-City Note") issued by Inter-City Gas Corporation and payable to Northern;

AND WHEREAS, as part of the said transaction, Inter-City Gas Corporation will issue to Norcen as fully paid 110,000 First Preference Shares 8% Series A (the "Preference Shares") having a redemption value of $700 each, whereupon Norcen will own in excess of 20% of the voting First Preference Shares of Inter-City;

AND WHEREAS the said transaction cannot be concluded without first obtaining the leave of the Lieutenant Governor in Council pursuant to Section 26 of the Ontario Energy Board Act;

AND WHEREAS pursuant to the said Act, the Ontario Energy Board has, following a public hearing, submitted to the Lieutenant Governor in Council its report and opinion dated January 16, 1985;

AND WHEREAS the Board's opinion is that with the provision of a bank guarantee of the Inter-City Note and certain undertakings by Inter-City, the transaction will meet the test of the public interest and would be recommended for approval;

AND WHEREAS Inter-City and Northern have jointly and severally undertaken and agreed as follows, for so long as Inter-City and its successors have a sufficient number of the outstanding voting shares of Northern to enable Inter-City to exercise corporate control over Northern, and for so long as Northern, itself or through a corporation over which it exercises corporate control, shall carry on the business of distributing natural gas in Ontario:

Inter-City and Northern will cause such portion of the current and future earnings of Northern to be retained in Northern as is from time to time appropriate for retention by a gas distribution utility regulated by the Ontario Energy Board, and to the extent that such retained earnings are not sufficient to maintain the equity of Northern at a level from time to time deemed appropriate for Northern by the Ontario Energy Board, Inter-City will provide additional equity capital sufficient for that purpose, on terms at least as favourable as Northern could itself obtain directly from the market; and, in the event Inter-City is unable or unwilling to supply such equity, Inter-City agrees and undertakes to permit Northern itself to raise equity from other sources including the issuance of shares to the public.

2. Northern will not pay dividends, or redeem, purchase or otherwise reduce or affect the amount or level of shareholders' equity of Northern, except in accordance with a dividend or distribution policy consistent with applicable business corporations statutes, trust indentures and Ontario Energy Board findings as to appropriate levels of equity of Northern.

3. Northern shall not borrow for, make loans or advances to, guarantee the obligations of or otherwise assume or become responsible for the obligations of Inter-City or any body directly or indirectly owned or controlled by Inter-City, without the prior consent of the Minister of Energy of Ontario.

4. The undersigned shall give timely notice to the Lieutenant Governor in Council of any occurrence (including, without limitation, any known, proposed or intended sale, disposition or transfer of shares of Northern or Inter-City) known to them which could result in any person acquiring such number of voting shares of Northern or Inter-City which, together with shares held by such person and by an associate or associates of such person, will in the aggregate exceed 20% of the voting shares outstanding of Northern or Inter-City (using, for the purpose of this Undertaking, the definitions provided in the Ontario Energy Board Act).

5. None of the costs of or incidental to the said transaction will be borne by Northern or included in the utility cost-of-service calculations of Northern or Inter-City Gas Corporation.

6. Northern's head office and main operating office shall be maintained in Ontario.

7. Northern will maintain on its Board of Directors at least two residents of its franchise area who at the time of their election or appointment have no pecuniary interest in Inter-City consolidated and no business connection with Inter-City consolidated, Northern, or any other natural gas distribution or transmission company.

8. Inter-City and Northern shall make reasonable efforts to accomplish a restructuring of Northern such that there will result a corporation whose assets, liabilities and activities relate only to the regulated natural gas distribution business in Ontario.

9. Inter-City will pay the principal on the Inter-City Note in instalments of $1,672,000 on December 31, 1988 and $4,148,000 on December 31 in each year 1989 to 1999 inclusive, or on such accelerated basis as the parties thereto may agree upon.

10. Inter-City shall, without expense to Northern, forthwith arrange a guarantee by a Canadian chartered bank of the Inter-City Note, the same to be maintained in force for so long as the Inter-City Note is held directly or indirectly by the corporation which operates the regulated natural gas distribution business in Ontario presently operated by Northern.

NOW THEREFORE leave is hereby granted pursuant to Section 26 of the Ontario Energy Board Act:

a) to the acquisition by Inter-City of all of the outstanding common shares of Northern; and

b) to the acquisition by Norcen of all of the Preference Shares;

both as contemplated by the said Agreement dated October 30, 1984.

Recommended Philip
Minister of Energy

Concurred George R. McCague
Chairman

Approved and Ordered January 24, 1985
Date

Lieutenant Governor

EXHIBIT "A"

TO: The Honourable The Lieutenant Governor in Council, under the Ontario Energy Board Act, concerning the Reorganization of Union Gas Limited and creation of Union Enterprises Ltd.

UNDERTAKINGS

The Applicants in this Petition, Union Gas Limited and Union Enterprises Ltd., do hereby undertake:

1. Indebtedness, Guarantees, Etc.

The Applicants undertake that Union Gas Limited, as constituted following the Reorganization, will not become responsible for the indebtedness for borrowed money of Union Enterprises Ltd., Union Shield Resources Ltd., or any other corporation which is an "affiliate" of Union Gas Limited (as defined in The Business Corporations Act, 1982 as from time to time amended or re-enacted), save for corporations which may be (i) subsidiaries of Union Gas Limited and (ii) "distributors", "producers", "storage companies" or "transmitters" (all as defined in the Ontario Energy Board Act, as from time to time amended or re-enacted) or otherwise subject to regulation under the said Act, in each case without the prior consent of the Lieutenant Governor in Council or the Ontario Energy Board, as may be appropriate in the circumstances.

2. Equity of Union Gas Limited

After giving effect to the Reorganization, the Applicants undertake as follows:

(i) that the portion of the current and future earnings of Union Gas Limited as is appropriate to its regulated utility operations will be retained in Union Gas Limited;

(ii) that Union Gas Limited will not pay dividends, or otherwise redeem, purchase, reduce or affect the amount or level of shareholders' equity of Union Gas Limited, except in accordance with a dividend or distribution policy consistent with applicable business corporations statutes and trust indentures and other borrowing instruments applicable to Union Gas Limited; and

(iii) that the Applicants will make reasonable efforts to retain in Union Gas Limited a level or amount of shareholders' equity appropriate to the regulated utility operations of Union Gas Limited, subject to being granted a competitive and appropriate rate of return on shareholders' equity and the components thereof consistent with the utility-capital requirements of Union Gas Limited.

If the Shareholders' equity of Union Gas Limited should fall below the levels or amounts determined by reference to the undertakings given in this section 2, then Union Enterprises Ltd. will make reasonable efforts to provide or cause to be provided to Union Gas Limited, directly or indirectly, additional shareholders' equity to attain the levels or amounts required, subject in each case to prevailing capital market conditions and the ability of Union Enterprises Ltd. and/or Union Gas Limited to raise equity capital on a competitive and capital-market related basis.

3. Change or Potential Change of Control

Given that, by reason of the Reorganization, the Applicant Union Enterprises Ltd. will not be subject to subsection 26(2) of the Ontario Energy Board Act, the Applicants herein undertake that the Applicants, and each of them, will give timely notice to the Lieutenant Governor in Council of any occurrence (including, without limitation, any known, proposed or intended sale, disposition or transfer of shares of Union Gas Limited or Union Enterprises Ltd.) known to them which would result in any person acquiring such number of shares of Union Gas Limited or Union Enterprises which, together with shares held by such person and by associate or associates of such person, will in the aggregate exceed 20% of the shares outstanding of that class of Union Gas Limited or Union Enterprises Ltd. (using, for the purpose of this Undertaking, the definitions provided in the Ontario Energy Board Act as from time to time amended or re-enacted).

4. Costs of Reorganization

The Applicants undertake that Union Gas Limited will not include any of the costs of the Reorganization in the utility cost-of-service calculations.

5. Management Costs

The Applicants undertake that the shared or joint costs of management, and other associated general administration and overhead costs, of Union Gas Limited, Union Enterprises Ltd., Union Shield Resources Ltd. and other corporations which directly or indirectly are part of the Union Group of corporations, will be allocated fairly among such corporations.

MADE on December 14, 1984.

UNION GAS LIMITED

By: ______________________
Chairman, President and
Chief Executive Officer

By: ______________________ c/s
Vice-President Finance
and Corporate Development

UNION ENTEPRISES LTD.

By: ______________________
Chairman, President and
Chief Executive Officer

By: ______________________ c/s
Treasurer

Ontario
Executive Council

Order in Council

On the recommendation of the undersigned, the Lieutenant Governor, by and with the advice and concurrence of the Executive Council, orders that

the appended Regulation be made under the Ontario Energy Board Act.

Recommended ______ Minister of Energy

Concurred ______ Chairman

Approved and Ordered December 20, 1984
Date

______ Lieutenant Governor

D/31

ROC552/84

REGULATION TO AMEND
REGULATION 700 OF REVISED REGULATIONS OF ONTARIO, 1980
MADE UNDER THE
ONTARIO ENERGY BOARD ACT

1. Regulation 700 of Revised Regulations of Ontario, 1980, as amended by section 1 of Ontario Regulation 330/81, section 1 of Ontario Regulation 805/82 and section 1 of Ontario Regulation 820/82, is further amended by adding thereto the following section:

5d.-(1) Union Gas Limited is exempted from the operation of or compliance with subsection 26(1) of the Act in respect of the amalgamation of Union Gas Limited and UNG (Subco) Limited pursuant to a scheme and plan of arrangement under the *Business Corporations Act, 1982* between Union Gas Limited, Union Enterprises Ltd., Union Shield Resources Ltd., UNG (Subco) Limited and their respective shareholders.

(2) Union Enterprises Ltd. is exempted from the operation of or compliance with subsection 26(2) of the Act in respect of its acquisition by way of share exchange of all of the outstanding common shares of Union Gas Limited pursuant to the scheme and plan of arrangement referred to in subsection (1).

SCHEDULE 6

UNDERTAKING

TO: The Honourable Lieutenant Governor in Council

Unicorp Canada Corporation ("Unicorp") and Union Enterprises Ltd. ("Enterprises") hereby undertake that if and so long as:

(i) Unicorp controls Enterprises; and

(ii) Enterprises controls Union Gas Limited ("Gas"); and

(iii) Gas remains a utility subject to regulation under the Ontario Energy Board Act as from time to time amended, re-enacted or substituted (the "OEB Act")

then Unicorp will vote its shares of Enterprises and Enterprises will vote its shares of Gas to accomplish the following:

1. Definition of Control

For the purposes of this undertaking "control" shall mean the right directly or indirectly to elect a majority of the directors of a corporation whether by ownership of shares, contract or otherwise and "controlled" shall have a similar meaning.

2. Indebtedness of Gas

Gas will not become responsible for the indebtedness of Unicorp, Enterprises, Union Shield Resources Ltd. ("Resources"), Burns Foods Limited or any other "affiliate" (as defined in the Business Corporations Act (the "OBC Act")) of Gas, except for subsidiaries of Gas that are subject to regulation under the OEB Act, without the prior consent of the Ontario Energy Board.

3. Loans and Investments by Gas

Gas shall not borrow for, make loans or advances to, guarantee the obligations of or otherwise assume or become responsible for the obligations of Unicorp, Enterprises, Resources, Burns Foods Limited or any other affiliate of Gas, except for subsidiaries of Gas that are subject to regulation under the OEB Act, without the prior consent of the Ontario Energy Board.

4. Financing of Gas

For three years from the date hereof, Gas will not increase its aggregate common share cash dividend beyond $27,000,000 per annum (plus an appropriate amount to reflect any additional common equity investment in Gas) plus an amount equal to the dividend received by Gas in respect of its holding of preference shares of Resources. Nor will Gas otherwise reduce shareholders' equity by way of redemption or purchase of common shares for cancellation if the effect would be to reduce the shareholders' equity of Gas below that used to determine rates in the most recently decided Gas rate case before the Ontario Energy Board from time to time.

Unicorp, Enterprises and Gas will cause such portion of the current and future earnings of Gas to be retained in Gas as is from time to time appropriate for retention by a gas distribution utility regulated by the Ontario Energy Board, and to the extent that such retained earnings are not or are expected not to be sufficient to maintain the equity of Gas (for this purpose, equity shall include both common and preferred shares) at a level from time to time deemed appropriate for Gas by the Ontario Energy Board, Gas will be permitted to raise equity at the times and in the manner considered prudent by its Board of Directors. If Enterprises or Unicorp through Enterprises wish to provide Gas with additional equity capital, they may only do so on terms at least as favourable to Gas as Gas could itself obtain directly in the capital markets.

Unicorp through Enterprises, or Enterprises may provide financing to Gas but only on terms no less favourable to Gas as Gas could itself obtain directly in the capital markets. In the event Unicorp or Enterprises is unable or unwilling to supply such financing, Enterprises and Unicorp agree and undertake to permit Gas itself to raise financing from other sources, including the issuance of securities to the public.

5. Regulated Activities

All current and future regulated utility activities under the control of Unicorp or Enterprises and governed by the OEB Act will be maintained in Gas or a subsidiary thereof unless the Ontario Energy Board otherwise determines.

6. Change of Control

The Ministry of Energy will be notified of any potential change of control of Enterprises or Unicorp.

7. Board of Gas

Members of the Board of Directors of Gas shall consist of:

(a) eight directors (the "Unrelated Directors") nominated by those directors of Enterprises elected by the shareholders of Enterprises other than Unicorp. The Unrelated Directors shall consist of persons who are not officers, directors or employees of and who have no pecuniary interest in Unicorp, Enterprises, any corporation controlled by either of them, any affiliate of either of them or any utility company (other than Gas) governed by the OEB Act (other than the ownership of shares of any such corporation representing less than one-half of 1% of the outstanding shares of any class of any such corporation). Not more than two of the Unrelated Directors may be officers or employees of Gas;

(b) five directors (the "Joint Directors") nominated by the Board of Directors of Enterprises. Not more than two of the Joint Directors may be officers, directors or employees of Unicorp, Enterprises or any corporation controlled by either of them or any affiliate of either of them (other than Gas); and

(c) two directors (the "Other Directors") nominated by Unicorp who may be officers or employees of Unicorp.

Enterprises undertakes to vote its shares of Gas to elect as directors of Gas the persons nominated as above, and Unicorp undertakes to vote its shares in Enterprises to cause Enterprises to so vote its shares in Gas.

The Directors of Gas shall have all the usual powers of directors under the OBC Act, provided all transactions between Gas or any corporation controlled by Gas on the one hand and Unicorp, Enterprises or any corporation controlled by either of them or any affiliate of either (other than Gas or any corporation controlled by Gas) on the other hand shall be subject to the approval of a majority of the Unrelated Directors.

At least 40 percent of the directors of Gas shall be resident in the franchise area of Gas.

If it is determined that the efficient management of Gas would be best served by a Board of Directors of a different size, the respective number of Unrelated Directors, Joint Directors and Unicorp Directors shall be increased or decreased proportionately as the case may be, provided that in no event shall Unrelated Directors constitute less than 51% of the directors of Gas.

8. Acquisition Premium

No part of the premium arising on the acquisition of shares of Enterprises by Unicorp shall be added to the rate base of Gas.

9. Head Office

The head office of Gas and all appropriate head office operations will be maintained in the City of Chatham.

10. Undertakings of Enterprises

The undertakings previously agreed to by Enterprises in its Petition to The Honourable Lieutenant Governor in Council dated December 14, 1984 are hereby adopted by Unicorp.

DATED this   day of April, 1985.

UNION ENTERPRISES LTD.	UNICORP CANADA CORPORATION
Per:__________________	Per:__________________
c/s	c/s
Per:__________________	Per:__________________